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A

TEXT BOOK

OF

Political Economy,

BY

E. C. ROBINSON, M.A., LL.B., Lond.,

2nd on list at M.A. Exam. in Mental and Moral Science;
John Stuart Mill Scholar in Philosophy of Mind and Logic at Univ. Coll., London;
Gerstenberg Prize in Political Economy at London University;
Ricardo Scholar in Political Economy at Univ. Coll., London;
1st Class Honours at London University in Roman Law, Jurisprudence, Common Law and Equity.

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PREFACE.

This book is intended primarily as a text book for students who are preparing for examination in Political Economy: especially the examination for the Teachers' Certificate.

I believe that a thorough knowledge of its contents will be found sufficient for a pass in any examination, which is not on some special department of the science.

I have endeavoured to select what is best in the works of the best economists, and to give their own words when possible. But I have not hesitated to take my own course on the points, and they are not few, where the views of the leading economists seemed to me lacking in clearness or accuracy.

The book, therefore, is not a mere compilation, but pretends to as much originality as can reasonably be looked for in a sober elementary work.

In addition to being useful to candidates, I hope it may be found to supply general readers with an intelligible outline of the science.

The candidate is recommended to read through the book once straight forward, and then to begin to study it.

The Index, the Table of Contents, the Cross-References in the Text, and the Questions and Notes which follow each chapter, should all be used until they become perfectly familiar.

Some few of the explanations given are rather beyond the scope of the book itself, and are intended to assist the student who may pursue the subject in other works. References to these are given with sufficient fulness to dispense with any formal advice as to additional reading.

E. C. Robinson.

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INTRODUCTION.

CHAPTER I.

THE NATURE OF THE SUBJECT.

1.—**Preliminary Definitions.**—Political Economy, or Economics, is the science of human conduct in relation to Wealth. *Wealth* is a term which applies to everything that has Value. A single item of Wealth is called a *Commodity*. *Value* is an attribute ascribed to a thing on the ground of its Exchange To say that a thing has value means that it may possibly be Exchanged for some other thing. "Thing" is here used in the widest possible sense, and not confined to material objects; it includes human Services and the temporary Hire of a thing, and legal Rights.

2.—**Exchange.**—The foregoing definitions are given provisionally, in order that we may use language intelligibly, and at once put ourselves in a position to mark out the *facts* that we are studying. The fact of Exchange is the central point of the science, and the consideration of what is involved in an exchange will enable us to define precisely the boundaries and the departments of our study.

Let us take a simple case of exchange and analyse it. H exchanges his hat for C's coat. This implies (1) that H desires the coat and that C desires the hat, and further, that H desires the coat more than the hat, while C desires the hat more than the coat; (2) that H has a legal right to the exclusive enjoyment of the hat, and can transfer that right to C. The same of the coat, *mutatis mutandis*.

Everything that can be an object of desire is said to have *Utility*, *i.e.*, capacity of satisfying desire, or, in other words, of giving pleasure or preventing pain.

We can now express briefly and clearly the reason why exchange takes place. It is not merely because there is a

[*In the cross-references, which are given in brackets, Roman numerals are used to denote Chapters and ordinary figures to denote Sections, thus* (iii., 4) *means "Chapter III., Section 4," and* (xxiv., xxviii.) *means "Chapters XXIV. and XXVIII."*]

"certain propensity in human nature to truck, barter, and exchange one thing for another" (ADAM SMITH'S *Wealth of Nations*, i., 2), but it is because there is a gain in Utility to both parties in every exchange. Reverting to our illustration, H desires the coat more than the hat; that is, the coat has greater utility to him than the hat; while C desires the hat more than the coat; that is, to him the hat has greater utility than the coat.

The same thing is expressed by saying that exchange is the "barter of the comparatively superfluous for the comparatively necessary" (JEVONS).

It would therefore be a mistake to suppose that the advantage derived from Exchange is the making of Profit. In the illustration of exchange which we have examined, nothing that can be called Profit is distinguishable. When profit is made, it is as a result of a complete process of production, of which Exchange is only part.

The fact that H is able by means of the hat to obtain the coat, is expressed by saying that the hat has Value, or "purchasing-power."

This "purchasing-power" may be measured by the quantity of things which can thus be obtained. If coat No. 1 exchanges for one hat, while coat No. 2 exchanges for two hats, all three hats being of the same sort, we may say that coat No. 2 has twice the value of coat No. 1.

The *Use* of a thing may be exchanged, *e.g.*, I may give a hat for a day's use of a bicycle, or for a day's work of a gardener. Such exchanges are called *Hire*. *Services*, therefore, whether of men or other things may have Value. In a slave-holding state, human beings may even be sold outright, and must then be regarded merely as commodities.

We now see that anything, or the use of anything, may have value, provided that (1) it has Utility, and (2) it can be held in ownership, and the ownership transferred.

The climate of a country, its form of government, and such abstract qualities as industry, strength, and skill, though they have great Utility, have no Value, because they either cannot be held in ownership or the ownership of them cannot be transferred.

It may seem strange at first to say that skill, strength, industry, good climate, or favourable geographical position, have no value. But the strangeness lies in the ambiguity of

the word "Value," which bears not only the meaning to which we restrict it, but also is used to denote very much the same thing as Utility.

Everything that has Value has Utility, but many things have Utility and not Value. Value in the sense of Utility is sometimes called Value in Use, as distinguished from Value in Exchange (or Exchange Value or Exchangeable Value), which we call simply Value.

3.—**Departments of Political Economy.**—A rough diagram may assist us to keep our ideas distinct.

Let the two lines A A and B B represent two commodities that are exchanged by two dealers C D and E F. The crossing of the lines indicates the fact of exchange, and the arrows indicate the respective giving and taking on the part of C D and E F.

Three inquiries are at once suggested:—

(1) How do commodities become fit for exchange?
(2) How are exchanges carried out?
(3) What becomes of commodities after they are exchanged?

These inquiries are dealt with in the four departments of Political Economy which are usually recognised:—

(1) **The Production of Wealth.** How do commodities become fit for exchange?
(2) **The Exchange of Wealth.** How is wealth exchanged?
(3) **The Consumption of Wealth.** How is wealth employed?
(4) **The Distribution of Wealth.** On what terms do persons combine their efforts for the purpose of production?

Hence Political Economy is sometimes described as the science of the Production, Exchange, Consumption, and Distribution of Wealth.

4.—**Human Conduct.**—We must note that all these activities—Production, Exchange, Consumption, Distribution—so far as they are the subject matter of Economics, are the actions of human beings living in society.

Production and Consumption no doubt involve other than purely "economic" activities. A full account of them necessitates reference to physical laws, such as are involved, *e.g.*, in the laws of Increasing and Diminishing Return (iii., 4), the law of Utility (i., 2), the principle of Division of Labour (vii., 3), the Efficiency of Labour (iv., 7), and the Functions of Capital (vi., 2). These laws must inevitably operate wherever and whenever wealth is produced. In the province of Distribution, on the other hand, there is little reference to physical laws. The law of Population (xxiii., 9) is such a law, but "Standard of Comfort" and "Standard of Life," which are the economic forms of the law of Population, depend on moral, not physical, principles. The laws of Distribution being thus moral, rather than physical, are more modifiable by human design. They will be different, *e.g.*, under Capitalistic production, or Co-operative, or Socialistic, respectively (xxiv., xxviii.).

But in all departments, Production and Consumption no less than Distribution, human activity is not "economic" unless and until it is affected by a conscious reference to wealth; and objects of desire ("goods" as we might call them) do not become wealth unless and until there is a possibility of their exchanging for other goods. All "economic" activity is human conduct with conscious reference to corresponding conduct on the part of other persons.

Economics is therefore a moral, or social (KEYNES) or moral and psychological (J. S. MILL) science. It studies the conduct of men living in society. A hermit or Robinson Crusoe cannot be the subject of true economic study.

Prof. Marshall says that Economics "is on the one side a study of wealth, and on the other, and more important side, a part of the study of man" (*Principles*, i., 1). The distinction here drawn seems unfounded. "Wealth" has no meaning apart from man; we cannot study wealth without studying man.

QUESTIONS AND NOTES.

Most of the Questions appended to each chapter have been selected from those given at various Examinations.

The following abbreviations have been used:—

Cert.	**Teacher's Certificate Examination.**
A. S. of Taxes	**Examination for Assistant Surveyor of Taxes.**
L.C.C. (*C.H. & P.E.*) *Senr.*	**London Chamber of Commerce Senior Examination in Commercial History & Political Economy.**
B.I., Prel. or *Fin.* ...	**Preliminary** or **Final Examination of the Bankers' Institute.**

1. "*Personal Wealth.*"—"We may define *personal wealth* so as to include all those energies, faculties, and habits which directly contribute to making people industrially efficient; together with those business connections and associations of any kind which we have already reckoned as part of wealth in the narrower use of the term" (PROF. MARSHALL, *Principles*, ii., 2).

The reference to the fact of exchange is the distinction between economics and other branches of study. It is therefore best not to include human "energies, &c." in the notion of economic wealth, unless for special reasons and with special explanations.

2. Define Wealth. Discuss whether or not the following come under your definition:—(*a*) the climate of a country, (*b*) the natural and acquired qualities of its people, (*c*) its good natural harbours, (*d*) its unworked mineral resources. (*Cert.*).

As to each item, ask (1) Has it Utility? (2) Can it be held in ownership, and the ownership transferred? Distinguish between giving another the *use* of a thing, and giving him the thing itself. A surgeon may transfer to you his services, but he cannot transfer to you his skill.

3. Explain, and comment upon, Mill's definition:—"Wealth may be defined, all useful or (*a*) agreeable things which possess exchangeable value, or, in other words, all useful or (*a*) agreeable things except those which can be obtained in the quantity desired, without labour or sacrifice (*b*)." (*Cert.*).

(*a*) To say that a thing is "useful or agreeable" is the same as saying that it has utility.

(*b*) Things which "can be obtained in the quantity desired without labour or sacrifice," will have a Marginal Utility (and therefore Value) of zero (viii., ix.).

4. "The laws of the production of wealth partake of the character of physical truths." "The distribution of wealth is a matter of human institution solely." Discuss the correctness of the contrast drawn in the above quotations, and explain *exactly* what you understand by an "Economic Law." (*A.S. of Taxes*).

5. Discuss the meaning of the term *value*, and show that, in every exchange, each party to the exchange gains something.

[*L.C.C.* (*C.H. & P.E.*) *Senr.*].

CHAPTER II.

METHODS OF STUDY.

1.—**Art and Science.**—"The term Art as properly used, seems to signify systematic express knowledge (with or without the implicit knowledge or instinct which we call skill) of the right means to a given end." (H. SIDGWICK).

An Art is defined by a statement of its End or the object which is sought to be accomplished. A Science is defined, not by any End, but by its Department. It is a body of generalised, organised, Knowledge.

We may thus distinguish Science from mere Knowledge :—A Science (1) Collects facts and laws which are intellectually related to each other;

(2) Explains those facts and laws in an orderly way, *i.e.*, the more simple before the less simple, and those first which are required for the comprehension of others;

(3) Defines the terms which it employs;

(4) Tests its facts and laws by the best methods known at the time;

(5) Seeks to generalise as widely as possible.

Logically, Science precedes Art. It is reasonable to first study and understand the subject matter with which one has to deal, before attempting to produce results by active interference. An Art may derive assistance from several Sciences. The art of navigation, *e.g.*, relies on the sciences of Mathematics, Astronomy, Geography, &c. The Art of Legislation or Government, of which Political Economy as an Art may be regarded as a part, requires the assistance of the Sciences of Ethics, Jurisprudence, Statistics, Economics, &c.

But historically, Art precedes Science. The practical necessities of life, the prompting to Do something, have occasioned the enquiries whose immediate object is merely the acquisition of knowledge. And bodies of knowledge, first accumulated with an ulterior practical purpose, continue to grow and to be studied with no such reference. Such has been the history of Economics.

Political Economy came into existence as an Art. The term "Economics" as originally used (*e.g.*, XENOPHON's *Oeconomicus*) was applied to treatises on the prudent management of farms and domestic affairs. Writers, therefore,

who conceived that a monarch or statesman had the function of arranging the industry of his country somewhat as the head of a household arranges its industry, called the Art, which offered him guidance in the performance of that function, "Political" Economy. Adam Smith thus states this view: "Political economy, considered as a branch of the science of a statesman or legislator, proposes two distinct objects: first, to provide a plentiful revenue or subsistence for the people, or, more properly, to enable them to provide such a revenue or subsistence for themselves; and, secondly, to supply the state or commonwealth with a revenue sufficient for the public services. It proposes to enrich both the people and the sovereign." (*W. of N.*, iv., *Introduction*). This, in spite of the employment of the word "science," is a definition of an Art. But in the hands of Adam Smith, only the second of his two heads was treated as an Art: "As regards the 'plentiful revenue or subsistence of the people,' Adam Smith, instead of showing the statesman how to provide it, has to show him how Nature herself would make ample provision if only the statesman would abstain from interfering with her processes: instead of recommending laws (in the jurist's sense) by which the national production and distribution of wealth *ought to be* governed, he has to trace the laws (in the naturalist's sense) by which these processes actually *are* governed." (H. SIDGWICK; *Principles; Introduction*, Ch. 2).

Thus the bulk of the "Wealth of Nations" consists of a scientific inquiry into the Production, Exchange, and Distribution of Wealth.

2.—**Relation to other Sciences.**—We are now in a position to observe the relations of Political Economy to other studies. As an Art it is a branch of Politics. As a Science it is a part of the Science of Society or, as it is sometimes called, Sociology. Comte and others have objected to severing Political Economy from the rest of the Science of Society. The objection seems good as regards the Art. If a question arises as to practical steps within the sphere of economic activity, it is necessary to take into account the whole of man's nature and everything which is likely to affect the desired results. But the objection does not seem good as regards the Science. In Science, progress can only be made

by specialisation. We can clearly delimit that portion of human activity which is economic, and the study of it in isolation is not only possible, but is the most highly developed portion of the science of Society.

An Art must as far as possible take into account everything that may affect the practical result. A Science must as far as possible leave out of account everything outside its own department. Every science is hypothetical, *i.e.*, it studies its subject-matter in isolation, whereas, in fact, things do not so exist. The levers whose laws are laid down in Mechanics are hypothetical. They are, *e.g.*, perfectly rigid, but none such exist actually. Hence, in applying scientific conclusions to practice, we have to make allowance for disturbing causes. Economics is in this respect not different from other sciences whose laws are sometimes applied to practice. Its subject-matter, however (human conduct), is the most complex of all, and is correspondingly difficult to reduce to formula.

3.—**The "Assumptions" of Economics.**—To say that a science is hypothetical is to say that it reasons from assumptions. The more nearly those assumptions agree with fact, the more nearly will the conclusions drawn from them also agree with fact. Political economy, therefore, "must both begin with observation and end with observation." It begins with observation for the purpose of making its "original choice of premises," and ends with observation "in order to illustrate, test, and confirm its deductive inferences." (Keynes; *Scope and Method of Political Economy*).

The most important assumption made in economics is that all economic activity is intelligent and competitive, and that the agent is able and willing to pursue his economic interests.

That this assumption very nearly corresponds with fact, at least in the higher branches of business, is proved by the comparative success of scientific prediction in such departments, particularly in the money-market.

With regard to economic activity generally, while it is true that the assumption is subject to many exceptions and limitations, still it is true that no other assumption can be made which will more nearly correspond with fact, and the correspondence which exists becomes closer with economic progress.

The proposition that all the movements of industry depend on price is truer now than when Malthus laid it down.

4.—**Economic "Laws."**—When we speak of economic "laws" we use the latter word in its scientific sense. Such a law is the statement of a uniformity which is not intentionally caused by human activity. Under given conditions the uniformity always exists as a tendency and produces its effect, but is, in fact, combined with other tendencies, and therefore its effect may not be directly observable. For instance, one of the most important of economic laws is that Price tends to be equal to Expense of Production (ix., 11), whereas such equality very seldom exists in fact. The theory of Differential Gain (xix., 6) explains a large class of apparent exceptions to the rule, and that of the variations between Market and Normal Values explains another. It is always true, however, that Price *tends* to be equal to Expense of Production.

Such "laws" are not to be confounded with "laws" in the juristic sense. These are commands, or rules of human conduct imposed and enforced by human authority. Scientific (including economic) laws are the statements of observed uniformities not dependent on human action designed to produce them.

5.—**Sketch of the History of Political Economy.**—(1) *The Mercantilists.* Political Economy, an essentially modern study, first became a separate body of doctrine early in the modern period of western history. The slavery of antiquity, or the feudalism of mediæval times, did not call for such a doctrine. But in the 16th century, mediævalism was nearing its last gasp, and new methods of government were coming into use. Concurrently there appeared a set of theoretic economic tendencies among writers on politics, which are collectively called "Mercantilism." These tendencies have been thus described by J. K. Ingram (*History of Political Economy*), following Roscher (a German economist):—

(1) "Towards over-estimating the importance of possessing a large amount of the precious metals";
(2) "Towards an undue exaltation (*a*) of foreign trade over domestic, and (*b*) of the industry which works up materials over that which provides them";
(3) "Towards attaching too high a value to a dense population as an element of national strength";
(4) "Towards invoking the action of the state in furthering artificially the attainment of the several ends thus proposed as desirable."

In earlier times, the English government had made many direct efforts to bring gold and silver into the country or prevent them from going out. The Mercantilists, without abandoning the same ulterior aim, saw that importation of the precious metals must ensue if other goods are exported to a greater value than are imported (xviii., 7), and they therefore devoted their chief attention to the "balance of trade" (*i.e.*, of imports and exports), styling the balance "favourable" or "unfavourable" to a given country, according as it tends to bring the precious metals into that country, or to take them out. Further, they saw that a favourable balance may be promoted, not merely by indiscriminately checking importation and encouraging exportation, but that in some cases the opposite course may be more effectual; *e.g.*, by encouraging the importation of tools and discouraging the exportation of raw material, they hoped to secure an exportation of manufactured goods of high value. The Mercantilist policy is therefore sometimes called that of the Balance of Trade. It was expounded in 1615 in a French treatise by De Watteville, which is interesting as first employing the title "Political Economy" ("*Traité de l'Economie Politique*") for the study.

(2) *The Physiocrats.* The principles of Mercantilism were applied in France in the oppressive system of Colbert. Out of the reaction towards economic freedom, which was part of the general movement towards freedom in France during the 18th century, grew the school and the doctrines of the Physiocrats, or "Economists," as they called themselves, a group of writers, of whom the chief were Quesnay (physician to Louis XV.), De Gournay and Turgot. The famous phrase "*Laissez faire, laissez passer*," expresses their doctrine that Government should leave industry free to be carried on as each individual judges best in his own interest. Such freedom is due by "natural" right ("Nature" being regarded by 18th century people, especially in France, as the infallible guide to wisdom), and also tends to the largest possible "*produit net.*" This net product is the excess of the mass of products of the earth over their cost of production.

Manufactures and commerce, said the Physiocrats, are not truly productive: they transform and transport goods, but the increased value thereby conferred only represents the quantity of provisions and other materials consumed during the operations. Hence it follows that taxation is most conveniently raised by an "*impôt unique*" or "*territorial*," a sort of land-tax.

(3) *The "Older English Economists,"* chief of whom are Smith, Malthus, and Ricardo.

Among the Mercantilists we see the beginnings of a theory of economics, in their reasonings as to certain indirect influences on the production of wealth. The Physiocrats shook themselves free from the disturbing influence of the precious metals, and advocated economic freedom, though often on fanciful grounds. Adam Smith's great work, "The Wealth of Nations," in 1776, consolidated the economic truths already attained, corrected the physiocrats' error as to the unproductiveness of manufactures and commerce, advocated the "system of natural liberty," and gave us the best model for economic enquiry which the world has yet seen. Since the "Wealth of Nations" appeared it has been impossible to defend Protection on purely economic grounds, though Free Trade was not adopted in England until 1846. In addition, and as part of his argument for Freedom of Trade, Smith elaborately expounded and illustrated the advantages of Division of Labour, and the nature and advantages of the use of money.

The famous "Essay on the Principle of Population," by T. R. Malthus, was published in 1798, and again, with considerable alterations, in 1803. This principle, in the form in which it has been found applicable to economics, becomes that of the "Standard of Comfort" (xxiii., 9).

David Ricardo wrote on economic subjects during the first quarter of the nineteenth century. He regarded Political Economy as "an inquiry into the laws which determine the division of the produce of industry amongst the classes who concur in its formation," rather than "an inquiry into the nature and causes of wealth." It is but natural, therefore, that while his Theory of Value is crude and incomplete, he contributed to Distribution that Theory of Rent, which, when generalised, has become the Theory of Differential Gain (xix., 6). "Standard of Comfort" and "Differential Gain" are to Distribution what Division of Labour is to Production, and Theory of Value to Exchange.

(4) *Mill and His Successors.* In 1848 appeared John

Stuart Mill's "Principles of Political Economy with some of their Applications to Social Philosophy." It is comparable with the "Wealth of Nations" in its summing up and systematising of the results of previous economic thought, but it is not comparable to that work in power or originality. It marks a period of transition. As we have seen, the principal theories of economic science had been sketched out, and were awaiting development, generalisation, and co-ordination. Mill did but little in that direction, and his greatest merits are his literary style, his zeal for reform, his moral elevation, and his belief in human improvement. We proceed to notice some of the points in which his theoretical exposition has been improved upon. He treats Distribution before Value, and does not exhibit the dependence of the former on the latter. He does not draw the distinction between Capitalist and Employer, and therefore gives no distinct account of Profit. He regards Value in internal trade as governed by different laws from those which operate in international trade. As to internal value, he adopts Ricardo's crude view that value is determined by Cost of Production (a phrase which he uses ambiguously both for Cost and Expense of Production). As to international value, he saw that Cost of Production is insufficient, and he had to take into account the influence of Demand.

Among later writers, W. Stanley Jevons has led the way in investigating the conditions of Demand. To him we owe the Theory of Diminishing Utility (viii., 6), but he went as far in the one direction as Ricardo had gone in the other, and made the futile attempt to found a Theory of Value on Demand alone. Subsequent writers, especially Prof. A. Marshall, have combined the theories of Ricardo and Jevons into a complete scientific account of Value.

The name of J. E. Cairnes is connected with the conception of "non-competing groups." Mill's theory of value in internal trade assumes that a man will as certainly find his way to that occupation which will best repay his efforts, as a bale of merchandise will find its way to the buyer who offers the highest price. Cairnes pointed out that "what we find in effect is, not a whole population competing indiscriminately for all occupations, but a series of industrial layers superimposed on one another, within each of which the various candidates for employment possess a real and effective power of

selection, while those occupying the several strata are, for all purposes of effective competition, practically isolated from each other" (*Leading Principles*, 1874). This conception breaks down the distinction between internal and international trade, in respect of the determination of value. Finally, we may note, as a remarkable feature of Mill's economic thought, his Wage-fund Theory (xxiii., 8).

We have already distinguished between the Science and the Art of Political Economy. Within the science a further distinction is sometimes drawn, viz., between the Deductive and the Inductive Method. We have noticed that Political Economy begins and ends with observation. Such observation and the accompanying logical processes constitute the inductive portions of the science, while the processes intermediate to the two sets of observations are more or less deductive. Some writers treat more fully of the inductive, others of the deductive portions of the science. Ricardo is the typical deductive economist. German writers have especially cultivated a wide observation of economic facts, and therefore the "historical" economists are sometimes spoken of as the "German" School, while the leading deductive writers are called the "English" School of economists. The "National" writers on Political Economy consider that it is impossible or futile to attempt to frame general economic truths, and that all that it is possible or desirable to attempt is that each nation should study its own economic interests and policy, inasmuch as these will necessarily differ from those of other nations. Such writers therefore can hardly regard Political Economy as a Science.

QUESTIONS AND NOTES.

1. *Continuity.*—Objects and events present themselves to our observation in unlimited variety, and therefore not in definitely marked series or degrees. Prof. A. Marshall uses the phrase "Principle of Continuity" to indicate this fact. *Natura non facit saltum* (a phrase, taken by Prof. Marshall as the motto of his "Principles"). But for purposes of study we are obliged to reduce this bewildering variety and "continuity" to order and limits. *We* must make classes, though Nature do not. The following passage will explain and illustrate Prof. Marshall's view:—"Another application of the principle of Continuity is to the use of terms. There has always been a temptation to classify economic goods in clearly defined groups, about which a number of short and sharp propositions could be made, to gratify at once the student's desire for logical precision, and the

popular liking for dogmas that have the air of being profound and yet easily handled. But great mischief seems to have been done by yielding to this temptation, and drawing broad artificial lines of division where Nature has made none. The more simple and absolute an economic doctrine is, the greater will be the confusion which it brings into attempts to apply economic doctrines to practice, if the dividing lines to which it refers cannot be found in real life. There is not in real life a clear line of division between things that are and are not Capital, or that are and are not necessaries, or again between labour that is and is not Productive." ("Principles," vol. 1: Preface to 1st Edition). The present book may appear obnoxious to Prof. Marshall's condemnation. In defence of the practice of attempting to define terms, it may be submitted, in addition to what has been said above, that (1) For scientific purposes it is necessary to study in isolation things which nevertheless cannot so exist. We cannot always make the order of study follow the order of Nature. The remark that "there is not in real life a clear line of division between things that are and are not Capital," is not to the point. If we are to use the term "capital" intelligibly, we must agree *how* to use it, and such agreement *ipso facto* draws a clear line of division between Capital and not capital, whether there is one in "real life" or not. The only possible question is—how can we use the term "capital" to best advantage? (2) Scientific knowledge cannot be assisted by confused, rather than by clear, thought. To think clearly, we must use terms with precision, and if we can use terms with precision we are able to define them. (3) This does not imply that having once defined a term we can never afterwards use it in a different sense. The same term may sometimes be usefully employed in different meanings, but only on condition that notice be given of the change from one to another, either by express definition or by the context.

2. Distinguish between Ethics, Politics, Economics, and discuss the question, "Should economics be studied independently of Ethics and Politics?" (*Cert.*).

It may briefly be said that Ethics is the science of the conduct of man to man; Politics is the science of the conduct of man to State, State to man, or State to State; Economics deals with the same subject matter as Ethics and Politics, but is distinguished by its point of view, or guiding notion. In Ethics the guiding notion is Virtue, in Politics it is Power, and in Economics it is Wealth. For the latter part of the question see ii., 2.

3. Give illustrations of the statement that Political Economy is involved with other branches of social science in most practical questions of trade. (*Cert.*).

4. Point out briefly what is the subject matter of Political Economy, and on what ultimate facts of nature, and human nature, economical laws depend. (*Cert.*).

"The desires, passions, and propensities which influence mankind in the pursuit of wealth are almost infinite; yet among these there are some principles of so marked and paramount a character as both to admit of being ascertained, and, when ascertained, to afford the data for determining the most important laws of the production and distribution of wealth, in so far as these laws are affected by mental causes. To possess himself of these is the first business of the political economist; he has then to take account of some leading physiological facts connected with human nature; and, lastly, to ascertain the principal physical characteristics of those natural agents of production on which human industry is exercised. Thus he will consider, as being included among the paramount mental principles to which I have alluded, the general desire for physical well-being, and for wealth as the means of obtaining it; the intellectual power of judging of the efficacy of means to an end, along with the inclination to reach our ends by the easiest and shortest means—mental facts from which results the desire to obtain wealth at the least possible sacrifice; he will further duly weigh those propensities which, in conjunction with the physiological conditions of the human frame, determine the laws of population; and, lastly, he will take into account the physical qualities of the soil, and of those other natural agents on which the labour and ingenuity of man are employed. These facts, whether mental or physical, he will consider, not with a view to explain them, but as the data of his reasoning, as leading causes affecting the production and distribution of wealth." (J. E. Cairnes, *Logical Method of Political Economy*" [1888], *pp.* 56-7).

5. "The laws of science are of precisely the same force in great things as in small." Show, by a few familiar examples, how this principle might be used in economical teaching. (*Cert.*).

The Law of Diminishing Utility may be illustrated by such familiar examples as eating, playing, &c. The Law of Diminishing Return may be illustrated by the diminution in quantity and quality of work where there is over pressure.

6. What is the subject matter of the science of Political Economy? Show by means of examples how economic laws differ in character from statutory laws. (*Cert.*).

7. What do you understand by the "historical method" of economics? To what extent has the progress of economic science been assisted or retarded by the application of such a method to economic study? (*A.S. of Taxes*).

8. Give an account of the chief economic writings of any two of the following:—Turgot, Ricardo, J. S. Mill, Jevons, and estimate their importance in the development of economic science. (*A.S. of Taxes*).

9. Adam Smith has been called "the parent of modern economics." Examine into the correctness of this description. In what sense and to what extent is there a "modern" science of Political Economy, and how far may the origin of that science be traced to the economic teaching of the "Wealth of Nations." (*A.S. of Taxes*).

10. What economic doctrines or developments are connected with the names of A. Smith, Ricardo, Malthus, and J. S. Mill? (*Cert.*).

11. Name some of the leading points in which the science of Political Economy has been modified since the work of A. Smith was first written. (*Cert.*).

12. Political Economy has been called a "theory of business:" state the characteristics of the science which justify the title. Bring out the nature of its investigations, the matter of its inquiry, and the special character of the principles obtained. (*B.I., Prel.*).

13. Explain the respective uses of Theory and Observation in practical economic inquiries. "If we can obtain a sufficient number of Facts, the Theories may safely be left to take care of themselves." Examine this statement, giving practical illustrations. (*B.I., Prel.*).

PRODUCTION.

CHAPTER III.

GENERAL CONDITIONS.

1.—"Production" and "productive" in Economics refer to the production of wealth. When the notion of wealth is restricted to gold and silver, the notion of production is similarly restricted. The Mercantilists (ii., 5) seem to have thought that the productiveness of foreign trade was to be measured by the quantity of the precious metals which it brought into the country. The Physiocrats took a wider view of wealth, but held the opinion that manufacture and trade are unproductive, and that the only activity which is truly productive of wealth is that which is employed in the cultivation or working of the land. Adam Smith and J. S. Mill enlarged the Physiocratic conception of productive activity, but still confined it to that which produces material commodities. But Services may be commodities (i., 2), and therefore we must regard their production as a production of wealth.

Strictly, "to produce" means to produce in a market, and a "producer" therefore is one who offers a commodity for sale. The labourer produces his services, the capitalist produces his loan, the employer produces the goods which he sends to market. There are as many instances of production as there are of exchange. The moment of exchange is the close of the period of the production of the exchanged commodity, and the commencement of the period of its consumption. This consumption, if productive (viii., 2), will itself be a period of production, the commodity going forward to another exchange either in the same or an altered form. The nailmaker produces nails which are consumed by the carpenter, in order to produce doors which consist in part of the nails. The retailer consumes large parcels of goods in order to produce the same goods, in smaller parcels, suitable for his customers' consumption. But we may conveniently use the word "producer" generally for any person who contributes to production; *i.e.*, as including labourers, landowners, capitalists, and employers: and cognate words will as a rule have a similarly wide signification.

2.—**The Requisites or Agents of Production.**—In order that a commodity may be offered for sale, one and the only indispensable requisite is Labour.

In the case where the commodity is human Service there is no other requisite. A strolling singer, for the promise of a coin, will exert himself, and so produce the Service which he sells to his hearers. If the commodity be a material thing—a wild flower, for example—some labour is necessary, and in addition "appropriate natural objects" (J. S. Mill), which we call land (v., 1). If the material commodity be one whose production requires operations of any appreciable duration or complexity, there is needed further the assistance of Capital (vi., 1). A wild flower may be "produced" in the economic sense, by merely plucking it and offering it for sale to the passer-by. But the production of a cultivated flower calls, in addition, for tools, however primitive, and for a period of waiting.

We distinguish a fourth requisite in the case of production on the scale of complexity which obtains in modern advanced communities. Long before a commodity can be put upon the market, information must be obtained, skill must be developed, plans matured, and responsibilities undertaken. There is Risk of loss, and the willingness to incur that risk, which we call Enterprise, is totally distinct from either of the three other pre-requisites of production.

The requisites of production have been stated rather differently at different periods of economic study. The Physiocrats emphasised the importance of Land, with a tendency to state economic laws as laws of (non-human) nature. Adam Smith emphasised the importance of Labour, and established Political Economy as a "moral" science (meaning by "moral" a science of human voluntary conduct, not necessarily the science of *right* conduct, which is called Morals or Ethics). J. S. Mill emphasised the importance of Capital.

Cairnes stated the requisites of Production as Labour, Abstinence, Risk. This enumeration is unduly restricted, since it omits the "appropriate natural objects," which we have seen to be required for the production of material commodities. "Abstinence" covers the personal sacrifice made by Landowner and Capitalist.

Professor Marshall states the requisites of production as Land, Labour, Capital, and Organisation. "Organisation," however, seems too vague to be a very useful notion.

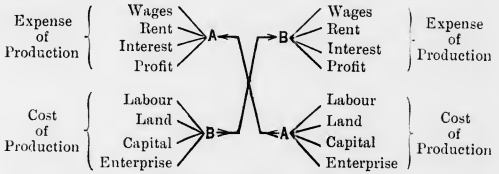
3.—**Cost and Expense of Production.**—A distinction is sometimes drawn between Cost of Production and Expense of Production.

The Cost of Production of a commodity is taken to mean the total amount of efforts, abstinences and risks required for its production. It is to be observed that we cannot reduce efforts or abstinences or risks to any common denomination, and therefore cannot compare any two "costs" of production as to quantity. Which effort is the greater, that of extracting a tooth, or that of carrying a hod of bricks up a twenty-foot ladder? The question is inept. We cannot even predicate equality or inequality between the efforts with which two men lift the same weight. To lift a hundred-weight is child's play to one, impossible to another.

The only conceivable way of measuring cost of production is by the price of the efforts and abstinences and risks involved. But then we are comparing not *cost* but *expense* of production. It will generally be found that when economists speak of "cost of production" they mean "expense."

The Expense of Production of a commodity is the sum of the prices that must be paid by a producer of such commodity before he can put it on the market, plus the quasi-price of the risk of loss that he himself incurs in so doing.

We may now repeat our diagram (i., 3) in a more developed form—



Under the head of Production we study the Cost of Production, *i.e.*, the efforts and sacrifices that must be made and the risks that must be run in order that wealth may be produced. Expense of Production, *i.e.*, the remuneration of such efforts and sacrifices and risks is studied under the head of Distribution.

4.—**Maximum Efficiency.**—The various agents of production may exercise their productive activity with greater or less intensity. An acre of land, for instance, may be made to yield a greater or smaller product; a labourer or a machine may do more or less work per hour, per day, per year; not of course without limit, but within bounds which vary with particular circumstances. It will usually, perhaps always, happen, that in any given case there is a degree of intensity, less than the highest possible, which may be called the point of maximum efficiency, such that if the intensity of the activity in question be either increased or diminished, the output will bear a smaller proportion to the energy employed to produce it. Simple hypothetical illustrations will make this plain.

(1) Suppose the point of maximum efficiency in cultivating wheat be represented by 4 men and 4 horses per acre. Then 2 men and 2 horses per acre will produce less than half the wheat that will be produced by 4 men and 4 horses, while 8 men and 8 horses will produce less than double.

(2) If 1 cwt. of coal per hour represents the point of maximum efficiency in working a locomotive engine, then 2 cwt. per hour will increase the speed but to less than double, while $\frac{1}{2}$ cwt. per hour will reduce the speed to less than half.

(3) Suppose that 9 hours' work per day gives a labourer's maximum efficiency. Then in $4\frac{1}{2}$ hours he will do less than $\frac{1}{2}$ as much work, and in 18 he will do less than twice as much, as in 9 hours.

This tendency of the agents of production is called the Law of Increasing Return, where output is being increased up to the point of maximum efficiency, and the Law of Diminishing Return where output is being increased beyond that point. Prof. Marshall speaks of a law of Constant Return in the case of production under such circumstances that the output, whatever its amount, bears the same proportion to the energy directed to its production. The law applies where the production of a commodity has two stages, in one of which Increasing Return operates, in the other Diminishing Return, in such a manner as to neutralise each other. It is evident that examples of Constant Return will be hard to find.

5.—**Agriculture and Manufactures.**—Much confusion exists in text-books in consequence of applying to the case of land a treatment different from that given to Capital and Labour. It is sometimes said that in agriculture the Law of Diminishing Return applies, whereas the Law of Increasing Return applies to Manufactures. The same notion is thus ex-

pressed by Prof. Marshall (*Principles*, iv., 13): "While the part which nature plays in production shows a tendency to diminishing return, the part which man plays shows a tendency to increasing return." But a reference to our examples given above, whose general accuracy everyone's observation will justify, shows that the application of the Laws of Return to each of the three Agents of Production is the same, *provided you make the same conditions*. As to Land, you suppose the same field, the same mode of cultivation, and if, as to Labour, you suppose the same labourer and the same mode of working; and as to Capital, the same capital and the same way of using it; but in each case an increase of the other agents of production: you get the same result as in the case of land.

We may state the Laws of Return thus:—Supposing that no change takes place in the methods of production: then if (1) with the same quantity of Land, we employ increasing quantities of Labour and Capital; or (2) with the same quantity of Labour we employ increasing quantities of Land and Capital; or (3) with the same quantity of Capital we employ increasing quantities of Land and Labour: then in each case, if we commence with very small quantities of the variable agents, we get an output which increases at a greater rate than those variable agents up to a certain point, but beyond that point increases at a less rate than those variable agents, and beyond further points will cease to increase and begin to decrease. "Constantly increased irrigation would convert the land into a swamp, instead of indefinitely adding to its fertility. Nor can abundant sowing be of any use when it reaches such a point that the plants stand so closely together as to interfere with their proper development" (Roscher, *Principles* [trans.], i., sec. 34, n.).

The real distinction between agriculture (or more broadly, the production of raw materials) and manufactures, lies in the fact that improvements in methods of production are more easily applied in the latter than in the former.

"The efficiency of human labour in the production of wheat may have increased six-fold since the days of the Odyssey; the efficiency of labour in converting that wheat into bread, as M. Chevalier computes it, has been multiplied one hundred and forty-four times. The efficiency of labour in producing wool may have increased four-fold in this long period, but many living men have seen the efficiency of labour in rendering wool into cloth multiplied fifty-fold." (F. Walker, *Wages Question* [1886], 99).

If the output of a manufacture be increased, it is almost always possible to introduce some improvement which will increase the quantity of the product, not only absolutely, but also in proportion to the energy expended. The increased proportional return is due to the adoption of improved methods. When improvements can be made in agricultural methods we get similar results.

An industry may be said to be in a condition of Increasing Return when its output is below the point of maximum efficiency. This implies that although it could put a larger quantity on the market than it actually does, at a lower expense of production, yet the increase in the supply would depress price so much that even at the lower expense of production, total profit would be less than on the smaller output at the higher expense of production and higher price (ix., 10).

Many manufactures could increase their output with a reduction of cost per unit if demand were greater.

This means that either their present methods are worked under conditions of Increasing Return, or that there are known improvements whose adoption the anticipated demand is too small to justify.

We may use the term Increasing Efficiency to denote that condition of industry in which an increase of output will probably be attended with such economies and improvements that the larger product will cost less per unit than the smaller.

But it must be remembered that the expression "Increasing Return" is usually employed for this notion.

QUESTIONS AND NOTES.

1. Land, Labour and Capital have been called the three requisites of production. Explain this statement, and offer any criticism upon it you may think desirable. (*Cert.*)
2. State the economical Law of Diminishing Returns, and point out any exceptions to its validity with which you are acquainted. (*Cert.*)
3. State and explain "the law of diminishing returns in agriculture" (*Cert.*)
4. Carefully explain the meaning of the terms Diminishing and Increasing Return, as used in economic science. "Increasing return is

the law of the human element in production, diminishing return of the element supplied by nature." Explain and discuss this, giving illustrations. (*B.I., Prel.*)

5. Explain what is meant by Increasing Return. "The unit of production in which the maximum economy arises must obviously vary with the elements of various industries. In some it is small, in others large." Explain and illustrate. Point out any cases in which the actual unit of production seems to you to be larger or smaller than the unit of maximum economy. (*B.I., Prel.*)

CHAPTER IV.

LABOUR.

1.—**Double Aspect of Labour.**—Labour maybe considered from the point of view either of the labourer or of the economic result. On the part of the labourer, it is human effort, whether of mind or body. The economic result is physical movement. Mental labour only produces economic effects when it causes physical movements. The labour of the poet directs the movements which print or write his compositions; that of the architect directs the movements which draw his designs and guide the artificers who rear the building. Bodily labour can do nothing, directly, but move objects; "nature, working within, does the rest" (Bacon). The agriculturist moves seeds into situations favourable for growth. The industrial chemist moves substances into positions which permit their mutual reactions. At every step the co-operation of "nature" is absolutely necessary. The watchmaker is as dependent on mechanical laws of nature as is the agriculturist on biological. We must not imagine that "nature" renders more assistance to one occupation than to another.

If we endeavour to classify Labour, the system we shall adopt will depend upon the point of view chosen, and this will depend upon the purpose of the classification. From the point of view of effort, we naturally classify Labourers, and this is the classification which is necessary in questions of Distribution. From the point of view of the result, we study the functions which are discharged, rather than the persons who discharge them. We therefore classify Labour, and this is the arrangement which is suitable for questions of Production. As an example of the distinction between classifying

Labourers and classifying their Labour, we may refer to what is called the Labour of Superintendence. As Labour, this is the same whether it be performed by the Employer or by a paid manager or overseer, and therefore in questions of Production, we need not inquire whether the labourer be the one or the other.

But the Wages of Superintendence of the Employer are only assimilated to those of the Manager as a result of economic analysis. The Employer himself reckons them in with his Profit, and his economic character is determined by his receipt of Profit, not of Wages of Superintendence. Employer and Manager belong to different economic classes of persons, and therefore, in questions of Distribution, they have to be distinguished.

2.—**"Labour is not creative of Objects, but of Utilities"** (J. S Mill).—It is obvious that labour cannot create matter. It can only move it, as we have seen, and by so doing render it more useful to mankind. Labour thus creates Utilities. Rough logs of wood will hardly serve the purposes of a table But the labour of the joiner confers upon the wood that utility which the word "table" implies, a power of satisfying a human want, of giving pleasure or preventing pain, which assists the table to obtain a Price in the market.

3.—**Classes of Utilities.**—Mill has thus classified Utilities:—

(1) "Fixed or embodied in an outward object"; such as that created by the labour of a table-maker.
(2) Fixed or embodied in a human being, *e.g.*, the skill developed in an apprentice by his master's teaching.
(3) Not embodied in any permanent form. Such are the Utilities created by the labours of public singers and dancers.

4.—**Productive and Unproductive Labour.**—Labour may be classed as productive or unproductive according as the utility which it creates is or is not intended to give value to some commodity. Much effort is expended without reference to the creation of value, *e.g.*, "labours of love" of all kinds, and the exertion involved in dressing, eating, walking, and amusing oneself.

J. S. Mill restricts the term "productive" to those forms of labour which create utilities fixed and embodied in outward objects. But we have seen that Services as well as material objects may be commodities, and there seems to be no reason why labour which creates services which are intended to be exchanged should not be called productive. The labour of a public singer produces a service which the singer exchanges for his fee. The service is a commodity, it has value, and therefore the effort which calls it into existence is productive labour.

The distinction which Mill suggests by the terms "productive" and "unproductive" labour seems best referred to the department of Consumption. When Labour has created Utility, the commodity in which such Utility is embodied may be consumed either productively or unproductively (viii., 2).

5.—**Classes of Labour.** — Substantially following J. S. Mill, we may classify as follows the human activities which must have been exerted in order to produce material commodities :—

(*a*) Labour expended directly on such commodities, as the labour of the bootmaker, joiner, etc., spent upon boots, tables, etc.

(*b*) Labour employed indirectly towards the production of such commodities :—

(1) Labour employed in producing subsistence to support subsequent labour. While the bootmaker is at work he must be fed, clothed, and housed ; and labour must have been previously expended that this may be done.

(2) Labour involved in producing materials, as leather for the bootmaker, boards for the joiner, etc.

(3) Labour involved in producing implements, as knives, awls, saws, lathes, etc.

(4) Labour employed in protecting labourers. This will include the whole machinery of the State : soldiers, judges, statesmen, etc.

(5) Labour employed in transport and exchange, including that of sailors, merchants, dealers, bankers, etc. The claim of bankers to be included, though perhaps not apparent at first sight, is a good one, since they are dealers in money (xv., 1), which is the medium of exchange (x., 5), and exchange is the means whereby commodities pass from producer to consumer.

(6) Labour which relates to human beings, as that of the surgeon, teacher, inventor, superintendent.

6.—**Classes of Labourers.**—J. S. Mill distinguishes four grades :—

(1) The liberal professions.
(2) Highly skilled manual labourers.
(3) Less highly skilled manual labourers.
(4) Unskilled labourers.

A person who has been brought up in either of these classes will usually remain all his life in that class, although better remuneration were to be had in another, and as a rule his children will be brought up in the same class. But movement from class to class is easier now than it has ever been hitherto, and will probably become still easier with the progress of society in intelligence, morality, and information.

The following classification, given by F. Walker, is of persons, not functions, and is made with reference to the mode in which the labourer is remunerated. It therefore refers to Distribution rather than Production.

(1) Employers, in so far as they themselves work in their business.

(2) The "cottar" or "ryot" or "metayer" (v., 2), who is really a partner with the landowner.

(3) Domestic servants, public singers, soldiers, and others, whose services are consumed unproductively.

(4) Labourers whose services are sold for productive consumption. These form the "wage-earning" class.

7.—**Industrial Efficiency.**—There may be a great demand for labour at the same time that a multitude of people are vainly seeking employment. The real demand is not merely for labour, but it is for trained, intelligent, efficient labour. F. Walker thus classifies the causes of differences in industrial efficiency :—

(1) **Peculiarities of stock and breeding.** "In the same quarry at Bonnières, in which Frenchmen, Irishmen, and Englishmen were employed side by side, the Frenchmen received three, the Irishmen four, and the Englishmen six francs a day. At those different rates, the Englishman was found to be the most advantageous workman of the three" (Brassey, *Work and Wages*).

(2) **Quality and quantity of food and clothing.** There is

here a point of maximum efficiency, analogous to that discussed in Chap. iii. Underfed labourers cannot do good work. Nothing is more injurious to society economically than to pay wages which are so low as not to permit the labourer to obtain sufficient food to develop his greatest strength and skill. Under such circumstances the labourer is not *worth* more than he gets simply because he is not *paid* more Greed and stupidity on the part of the employer, and those circumstances which impede effective bargaining on the part of the labourer (xxiii., 5), often prevent the employer himself from making greater profits than he actually does, and also prevent the labourer from living a vigorous, reasonable life.

(3) **Sanitary conditions.** These, by affecting the general health, affect the labourer's efficiency.

(4) **General intelligence**, which, as it increases, diminishes the difficulty of instruction, reduces the necessity for superintendence, lessens waste of time and material, and enables delicate and intricate machinery to be employed. The enforcement by the State of universal elementary education may be expected to promote the general intelligence of the people, and thus to increase the industrial efficiency of labourers.

(5) **Technical education and industrial environment.** Technical, industrial and commercial education differ from general education in that they are undertaken primarily for the sake of Production, whereas general education, though it promotes industrial efficiency, is not undertaken primarily for that purpose. The services which are involved in technical education may therefore be consumed productively.

If an employer gives technical education to his staff, the cost of it is part of the expense of production of his commodity. Where such education is given at the expense of the labourer himself or his parents, such expense resembles investments. The cost is "sunk" in rendering the labourer a more efficient instrument of production. But technical education is apt to be very inefficiently administered when left to employer or labourer. (*a*) The employer cannot be sure of receiving the return to his outlay. His trained labourer may leave his employment. (*b*) The labourer himself and his parents cannot or will not usually afford the expense. Hence State intervention seems to be called for.

In a country where industry is highly organised and highly

efficient, imitation and emulation evoke powers which otherwise could not have been developed. In the case of "localised" industries, a predisposition to acquire the appropriate technical skill becomes hereditary in the district.

(6) **Moral causes:** "cheerfulness and hopefulness in labour, growing out of self-respect and social ambition, and the labourer's personal interest in the result of his work" (F. Walker, *Wages Question*, 72). Slave-labour is notoriously inefficient.

QUESTIONS AND NOTES.

1. Distinguish the various classes of labourers required before any article of food, such as coffee or sugar, can be brought to the consumers' breakfast table. (*Cert.*)

2. State and briefly explain the conditions on which the efficiency of human labour depends. (*Cert.*)

3. How may a good system of National Education, both general and technical, be expected to increase the efficiency of labour? (*Cert.*)

4. How is the productiveness of labour likely to be affected by the industrial classes receiving both a better *general*, and a better *technical*, education? (*Cert.*)

5. Discuss the meaning of the word *productive*, as applied to labour engaged in Agriculture and in Commerce respectively. (*L.C.C. Senr.*).

See Chap. 3, for the meaning of "productive" in economics, and the views of the Physiocrats. See Chap. 4, for "productive labour."

The question raises the distinction between *quantity* and *value* of output.

6. Indicate the chief causes which influence the efficiency of the individual labourer in the production of wealth. Discuss the use of the words "necessaries," "productive," in Political Economy. (*Cert.*)

CHAPTER V.

LAND.

1.—The word **Land** is used in economics in a technical sense, to denote wealth which is not itself the product of industry. It is wider than "land" in the ordinary sense of that term, since it would include a fishery, if held as private property. It is narrower than "gifts of nature" or "appropriate natural objects" (J. S. Mill), since sunshine, fresh air, &c., which are included in these notions, but are not subject to ownership, and therefore are not wealth, are excluded. The distinction between Land and Capital is this—that the latter is,

while the former is not, itself the product of industry. The cultivated fields of England owe their valuable qualities in large measure to the labour which has been expended on them in past times. We may therefore in thought make a distinction between the "natural and indestructible powers of the soil" (RICARDO), such as situation, light and air, together with its original mechanical and chemical properties, and call these "land," and the powers which are due to past industry, and call these "capital." But the distinction seems useless (xx., 1; xx., 10).

2.—**Forms of Tenure.**—In economic theory it is generally assumed that land is held in the manner which is usual in England, *viz.*, owned by the "landlord," and let out by him at a "rent" to the "tenant" who employs it, together with hired labour and (in part) borrowed capital. It is further assumed that landlord and tenant each make the best bargain they can, and that there is free competition among landlords and tenants respectively. This latter assumption is more nearly realised in North America than in England, where custom and sentiment generally make the terms on which farmers hold agricultural land easier than they would be if regulated by economic forces alone. But in respect of land used for buildings and manufactures, the assumption corresponds fairly well with fact. In Ireland, until recently, sentiment and improvidence on the one hand, and on the other the fact that the bulk of the better class of landowners lived abroad ("absentee landlords") had the opposite effect of making rents higher than their true economic level, with consequent suffering and discontent. Since 1881 it has been found necessary to get rents in Ireland adjusted by state officials.

Land is, however, in many cases held under other conditions than those of landlord owner and tenant farmer.

In Belgium, France, and elsewhere, there are large numbers of "peasant proprietors," each owning and cultivating a plot no larger than can be managed by himself and his family.

Over large tracts of the earth's surface cultivation is carried on by peasants who pay for the use of the land in other ways than by a bargained money-rent. Such "peasant rents" may be thus classified:—

(1) **"Serf" or "Labour" rents.** The tenant pays for his holding by rendering an agreed quantity of work to his lord.

(2) **Métayer-rents.** The landowner provides the land and the bulk of the capital; the cultivator provides small working implements and the labour, and hands over to the landowner a customary proportion of the produce, usually a half. The system is very usual in Italy, Portugal, the countries along the Danube, Russia, and France. It prevents disputes, being really a partnership between the landowner and the cultivator; but it stands in the way of progress, neither party being willing to make improvements, of whose benefit he is only to get half.

(3) **Ryot rents.** The cultivator is the owner of the land, subject to the payment of a proportion of the produce to the Government. Such a rent is much the same as a land tax. This system largely prevails in India.

(4) **Cottier rents.** "Cottier" originally meant a subtenant who rented a cottage and an acre or two of land from a small farmer; but it has come to include all peasant farmers.

3.—**Large and Small Holdings.**—The chief economic distinctions between these various forms of land-tenure depend on—

(1) Whether the terms on which the employer holds the land are determined by Custom or Bargain and Competition;

(2) Whether the "large" or the "small" system of cultivation is pursued.

(1) A customary rent resembles a land-tax, and the customary tenant resembles a proprietor. In the case of small holdings the "magic of property" is strongly in favour of the employer being also the landowner. "Give a man the secure possession of a bleak rock, and he will turn it into a garden; give him a nine years' lease of a garden, and he will convert it into a desert." (A. YOUNG.) But where land is employed in large parcels (the "large" system), it seems best that the employer should hire the land from the owner. In this case the employer uses his own capital in cultivation, the owner usually making permanent improvements. But where the owner is also the employer, he regards the land itself as his capital, and he cultivates with borrowed capital, the interest on which is more oppressive than the rent which he would have to pay were he not owner.

(2) The advantages of the large system are most apparent

in the cultivation of wheat and forage. They consist in greater economy of effort, *inter alia* by the employment of machinery, and in the more ready adoption and invention of improvements. The small system seems the more suitable to crops which require much and minute attention. It generally gives a greater gross, though perhaps a smaller net, produce than the large system. The advantages of peasant proprietorship on which stress is chiefly laid are social and moral: independence, manliness, industry, limitation of population. *Per contra*, it is said that frequently peasant proprietors work *too* hard, and deny themselves *too* much, and thus pay for the improvement of the earth by the deterioration of its owner. In some cases, peasant proprietors on the Continent of Europe have been found worse off than English agricultural labourers; while limitation of population is a doubtful gain (xxiii., 11).

QUESTIONS AND NOTES.

1. Discuss the advantages of small portions of land held in freehold by peasant proprietors. (*Cert.*)

"Freehold" is the most unrestricted form of ownership.

2. What are the chief forms of land tenure which obtain in Europe? Comment briefly on two of them from the economical standpoint. (*Cert.*)

CHAPTER VI.

CAPITAL.

1.—**Capital** is wealth which has been produced by past industry and is destined to assist in the production of wealth, or, in other words, is devoted to Productive Consumption (viii., 2).

"Whatever things are destined to supply productive labour with its various pre-requisites are Capital" (J. S. Mill). Whether wealth is or is not capital thus depends on the intention of the person who has control of it. For some purposes it may be necessary to disregard such intention, and to treat all wealth as capital which is capable of being so employed.

2.—**Functions.**—Capital enables production to be carried on by processes which ultimately economise effort, but require

Time and Contrivance and Organisation. The savage plucks up a root and devours it on the spot. The modern Englishman feeds more economically on wheat which grows thousands of miles away from his home, and is carried to him in ships, which take many months to build, and over railways, which tens of thousands of men laboured many years to construct. It is Capital which enables such a result to be attained.

Historically, the functions of capital in assisting production seem to have followed some such order of development as the following, which has been traced by Prof. Ashley in the cloth trade:—

(1) *Seeking markets.* Up to the 14th century, each weaver had to find customers for the cloth that he made. But in the middle of that century, there appears a class of "drapers," who bought cloth from the weavers and supplied it to customers in distant markets.

(2) *Organisation.* As early as in Tudor times, in some parts of England, the whole manufacture was arranged by master-"clothiers," who provided the wool and employed carders, spinners, weavers, dyers, fullers, &c

(3) *Supplying Implements.* From the first the master-clothiers owned looms, fulling-mills, and gig-mills.

About the middle of the 18th century began the great series of inventions which revolutionised industry, and gave capital the preponderant importance which is reflected in the writings of economists for a century onwards.

3.—**Kinds of Capital.**—Capital may be classified in various ways, according to the purpose of the classification.

Fixed and Circulating. Circulating capital fulfils the whole of its office in the production in which it is engaged by a single use. Wages and materials may be given as examples. That portion of his capital which an employer devotes to the payment of a week's wages cannot again serve him as capital. The raw cotton which is spun, or the fuel which is burnt, can only once be employed in that particular way. Fixed capital, on the other hand, is capable of fulfilling its office in the production in which it is engaged more than once. It includes buildings, machinery, tools.

Sunk and Floating. Capital is said to be "sunk" when it has assumed a form which cannot be changed. For example, expense which has been incurred in draining land

is "sunk." It cannot be recovered. But, of course, its results may amply compensate for the sacrifice.

Capital is said to be "floating" when it is ready to take any desired form. Money is the typical example.

Mill describes sunk capital as "rendered permanently incapable of being applied to the maintenance and remuneration of labour."

Willingness to sink capital indicates—

(1) Security of property;
(2) Activity of industrial enterprise;
(3) High standard of the "effective desire of accumulation;" which are features of a society rapidly progressive in its amount of capital.

Remuneratory and Auxiliary. Remuneratory, or wage, capital, is that which the employer devotes to the remuneration of labour, Auxiliary capital including all other forms, such as materials, tools, &c. If a labourer have the use of a house rent-free as part of his wages, the house is Remuneratory Fixed Capital.

A rapid conversion of floating into sunk capital, on a large scale, may injure labourers by reducing the available supply of Remuneratory Capital. Such was the effect of the large construction of railways in this country in the year 1847. But such conversion is always made in view of increased returns, whose ultimate effect is to increase the supply of remuneratory capital.

The proportion of remuneratory to auxiliary capital depends on—

(1) The nature of the particular business. A merchant needs a smaller proportion of remuneratory capital than does a manufacturer.
(2) The state of the arts. New inventions usually require a higher proportion of auxiliary capital.
(3) The relative cost of capital and labour. An employer often has a choice, within limits, of employing various proportions of capital and labour for the production of the same goods. He may have sewing done by hand or by machine, &c., in the former case paying more wages, in the latter, more interest on the larger fixed auxiliary capital employed. Thus there is a kind of competition between capital and labour. See further, note 12 *infra*.

Specialised and Non-specialised. Some forms of capital can be adapted to any or several trades, and are therefore called Non-specialised. Other forms can be diverted from a particular trade only with difficulty, or not at all. These are called Specialised. An ordinary retail shop is non-specialised: it will serve with slight alterations for many trades. A cold-storage warehouse is specialised: there are few kinds of goods that need such accommodation. Specialisation of capital may cause irregularity of employment, since in case of slackness of the trade for which it is designed, specialised capital cannot be used for other purposes.

4.—**Capital and Labour.**—It is sometimes said that the capital of a community may be classified under the three heads: Subsistence, Tools, Materials.

Tools and Materials, again, may be looked on as representative of Subsistence. That is, they represent the food consumed by the labourers who produced them, during the period of production. Thus, Capital is regarded as a kind of preserved Labour. But it may be doubted whether this view has much to recommend it. The laws to which Capital conforms are different from those governing Labour.

5.—**Capital and Money.**—"Capital" and "Money" are often used synonymously. In order to compare the terms, we must remember that money is wealth (x., 6), that wealth devoted to productive consumption (consumption in the case of money being the spending of it) is capital, and that, therefore, money is capital if it is employed for the purpose of producing wealth, and not otherwise.

We may notice some causes of confusion. Profits are made when, and not as a rule until, a product is sold. The price which is received replaces the capital consumed in the production. Again, when capital is lent or returned, it generally takes the form of money at the moment of transfer.

It is therefore very natural to speak of "money" and "capital" interchangeably. But we must not forget that there are many other forms of capital beside money; and also that money when consumed (*i.e.*, spent), for the purpose of obtaining satisfaction direct, and not for the purpose of producing wealth, is not capital.

Money as Capital is Circulating (since it fulfils its office by being exchanged away, not by being kept, as a rule), either Remuneratory or Auxiliary, Non-specialised, and Floating.

6.—**Mill's Propositions.**—J. S. Mill lays down the following four "fundamental propositions respecting Capital:"

(1) Industry is limited by Capital.
(2) Capital is the result of saving.
(3) All Capital is consumed.
(4) Demand for commodities is not demand for labour.

(1) In the latter part of the 18th and the early part of the 19th century, England was maintaining wars which consumed vast quantities of wealth unproductively; at the same time the knowledge and use of machinery and the "large system" of production were rapidly extending. Supply of capital was not keeping pace with demand, and interest, therefore, rose to a great height. The advantages of Capital were so keenly felt that they were strongly emphasised by economists.

To-day there is an ample supply of capital and a low rate of interest. Few otherwise hopeful schemes of production have to be abandoned on account of lack of capital in the community. On the contrary, it is unproductive consumption that now needs stimulating and refining.

We find in England on the whole a greater eagerness to produce and save than to enjoy and consume wealth.

Economists were taught by the experience of last century that "industry is limited by capital," for they saw how the expansion of industry was hampered by the continual drafting off of wealth for unproductive consumption.

Whether Mill's dictum that "increase of capital gives increased employment to labour without assignable bounds" is equally accurate, is more doubtful. We shall see (viii., 4) that expansion of production needs to be supported by expansion of unproductive consumption, which does not necessarily take place at the same time.

(2 & 3) Capital is saved in the sense that it is not consumed unproductively. It is, however, consumed (viii., 1). A distinction may be drawn between saving and hoarding. Hoarded wealth is not capital. The miser's gold does not assist production. But if he deposit it in a bank, the bank will employ part of it productively, and therefore as capital.

It has been said that there is not a nail in all England which cannot directly or indirectly be traced back to savings made before the Norman Conquest (Senior).

(4) The proposition, "demand for commodities is not demand for labour," seems either a truism or a paradox. If

we include Services among Commodities, then some cases of demand for commodities *are* cases of demand for labour. But if we exclude Services from Commodities, as Mill does, then it appears that literally the proposition is true, but a truism. The statement must be understood thus—that if demand for commodities (excluding services) increases, it does not necessarily follow that demand for labour will also increase.

This proposition is true, although at first it looks paradoxical. It would appear that if demand for commodities increases, demand for labour must also increase for the purpose of producing such commodities. If the demand for pictures should increase, more labour will in consequence be expended on the production of pictures. But the extra money spent on pictures would have been spent, if not on pictures, then on something else, and to the same extent to which it encourages picture-labour, it does not give the encouragement which it otherwise would do to other kinds of labour.

Mill's real object in laying down the proposition seems to have been to distinguish between the effects of a demand for commodities for productive, and those of a demand for commodities for unproductive, consumption. As to the latter, the proposition is true; as to the former, it is false.

(*a*) The productive consumption of commodities always involves labour, and therefore if demand for commodities for such consumption should increase, there must be a corresponding increase in the demand for labour. If a builder increases his purchases of bricks and timber, he must at the same time increase his wages-bill to pay the bricklayers and carpenters, whose services are necessary for turning the bricks and boards to account. The immediate result may be different where the commodity in question is a "labour-saving" machine. But even in that case, the ultimate result is usually an increase in the demand for labour.

(*b*) No such consequence is necessary in the case of an increased demand for commodities for unproductive consumption. If a man increases his outlay on pictures or velvets or wines, he needs no hired labour to assist him in consuming those articles.

It would seem, therefore, that Mill's proposition should be limited to commodities intended for unproductive consumption.

7.—**Growth of Capital.**—"The fund from which saving can be made is the surplus of the produce of labour [&c.] after supplying the necessaries of life to all concerned in the production (including those employed in replacing the materials, and keeping the Fixed Capital in repair). More than this surplus cannot be saved under any circumstances. As much as this, though it never is saved, always might be. This surplus is the fund from which the enjoyments, as distinguished from the necessaries of the producers, are provided; it is the fund from which all are subsisted, who are not themselves engaged in production, and from which all additions are made to capital. It is the real net produce of the country." (J. S. MILL, i., 11, § 1).

The amount of wealth that is saved depends on (1) the power, (2) the will, to save.

(1) The power of saving depends on the efficiency of industry. During the greater part of the world's history the rent of land has been the chief source of saving. In most countries, except England, greater surplus incomes are derived from rent than from interest or profit, and landowners are numerous and thrifty. In England the wages of manual labour contribute an increasing amount to capital. Deposits in Savings Banks amounted, in 1830, to 12½ millions, in 1888 to 88½ milions. The net assets of Building Societies in the United Kingdom were 25¼ millions in 1874, 38 millions in 1888. A large proportion of these amounts has been saved from wages.

A high rate of interest encourages accumulation, and provides a fund for further saving. The same may be said of high wages, but a greater proportion of interest is saved than of wages.

(2) The will to save depends on temperament more than on rate of interest. It is affected by the following circumstances:

(*a*) Foresight.
(*b*) Security.
(*c*) Timidity and tendency to expense. A timid or dull nature is less tempted to unproductive consumption than one that is bolder or more susceptible.
(*d*) The social estimation and political power of wealth.
(*e*) Tenacity of habit of work. This is strong in the English race, and causes production in many cases to be carried on far in excess of the desire for unproductive consumption, and independently of it. F. Walker thinks it an absurdity to suppose "that men will labour to produce that which they have not the desire to consume." But we frequently find men actually doing so (viii., 5).
(*f*) Means of investment. The spread of banking, including the Post Office Savings Bank, of Building and Friendly Societies, of joint stock enterprise, of Co-operative Stores selling goods at market price and returning a portion of their profits to customers as "bonus" ("saving under chloroform") has greatly promoted saving among classes who, without special facilities, would not practise thrift at all.

Where the effective desire of accumulation is low, there are needed—

(1) Better Government;
(2) Improvement in the intelligence of the people;
(3) The introduction of foreign arts to stimulate desires.

The total wealth of England and the United Kingdom has been estimated at various periods as follows:—1660: 250 millions (England and Wales); 1774: 1,100 millions (E. & W.); 1812: 2,190 millions (United Kingdom); 1840: 4,100 millions (U.K.); 1865: 6,113 millions (U.K.); 1875: 8,548 millions (U.K.); 1885: 10,037 millions (U.K.). The figures for 1865, 1875 and 1885 include the capitalised value of farmers' profits and incomes derived from trades and professions. To eliminate these items, some 1000 millions should be deducted from the figures for 1885.

8.—**Consequences of Large Capital.**—The accumulation of capital on a large scale has important consequences, not only economic, but also social and political.

(1) Continuity of employment is favoured, since there is usually considerable loss involved in a cessation of work in an establishment employing a large capital. There are furnaces such that £10,000 is sacrificed by letting one go out of blast.

(2) Investment and insurance, of a kind which is not possible unless capital is ample and dealings in it well-organised, diminish the uncertainty and anxiety of life.

(3) Production on the large system socialises labour and necessitates rule and discipline. Character is thus made steadier and firmer.

On the other hand, the control of large masses of capital

gives a power which Socialists believe is not fit to be in the hands of private persons, and which all are agreed needs regulation by the state in at least some cases. Its abuses are—

(1) Exploitation ; the treatment of labourers as mere agents of production, without regard to their claims to consideration as human beings.

(2) The exaggeration or creation of fluctuations in prices and employment.

(3) Large combinations, replacing Competition by Monopoly.

(4) Unfair competition, aiming at the economic murder of competitors by selling, for a time, at less than expenses of production, so as to drive others out of the trade, and then obtain compensation for temporary sacrifices by monopoly prices.

QUESTIONS AND NOTES.

1. Define Capital, and indicate briefly the services rendered by capital in production. (*Cert.*)

2. Give an account of the principal distinctions drawn by Economists between different kinds of capital; and illustrate the use made of these distinctions in economic theory. (*A.S. of Taxes.*)

3. Define capital, and explain the difference between fixed and circulating capital. In which if either class would you place a bicycle, (*a*) when in the maker's workshop, (*b*) when used by a tradesman in delivering his goods, (*c*) when used for recreation? (*Cert.*)

(*a*) Circulating, (*b*) Fixed, (*c*) Strictly, not capital at all, since used for unproductive consumption. But since it is wealth of a durable character (*i.e.*, its utility is not exhausted by a single use), it might be called, if we chose to use the expression, "Consumer's *Capital*."

4. Distinguish between Fixed (or Auxiliary) and Circulating (or Remunerating) Capital; and point out the effects, both temporary and permanent, of a large and rapid transfer from the latter to the former. (*Cert.*)

5. Define capital. Distinguish fixed and circulating capital. Discuss the statement that the industries of a country are limited by its capital. (*Cert.*)

6. "Trade is the child of capital—it is *quantity of capital*, not *extent of market*, that determines the quantity of trade."

(*Jeremy Bentham, 1793.*)

Consider this position, with especial reference to the circumstances of the time at which it was made, and to those of the present day. (*B.I. Prel.*)

7. Define Capital. Describe precisely its functions in the production of wealth, examine into the main causes which determine its increase, and estimate the adequacy of the classifications which have been made of its varieties by different economic writers. (*A.S. of Taxes.*)

8. State carefully the conditions that determine the growth of capital. What methods may be employed to measure the growth of national capital during a given period? (*A.S. of Taxes.*)

9. State, and classify carefully, the main conditions affecting the increase of capital.

How far do you think the prosperity of industry in this country is now, or has been in former times, principally dependent on the increase of capital. (*B.I. Prel.*)

10. Explain the term "Capital." How do large accumulations of capital affect the wages of the labouring classes? (*Cert.*)

11. *Substitution.*—The competition between capital and labour is a special case of a general principle thus described by Prof. Marshall (I. "Principles," v. 3). "As far as the knowledge and business enterprise of the producers reach, they in each case choose those factors of production which are best for their purpose ; the sum of the supply prices of those factors which are used is, as a rule, less than the sum of the supply prices of any other set of factors which could be substituted for them; and whenever it appears to the producers that this is not the case, they will, as a rule, set to work to substitute the less expensive method. And . . . in a somewhat similar way society substitutes one undertaker for another who is less efficient in proportion to his charges. We may call this, for convenience of reference, *The principle of substitution*"

12. "*Consumers*" *and* "*Consumption*" *Capital.*—Goods whose unproductive consumption extends over a considerable period of time—as furniture, &c.—are sometimes called "Consumers' Capital." "Consumption Capital" is used in a different sense :—

"*Consumption Capital* consists of goods in a form to satisfy wants directly ; that is, goods which afford direct sustenance to the workers, such as food, clothes, house-room, &c." (Marshall, *I. Principles*, ii., 4). This is included in Remuneratory Capital.

CHAPTER VII.

ORGANISATION OF INDUSTRY.

1.—**Combination of Effort.**—The organisation of industry begins when several men join together to work, each in the same way as the others, for the purpose of accomplishing a task beyond the strength of any individual.

2.—**Separation of Employments.**—In very rude societies it may be possible for each person to discharge the same industrial functions. Every man may be a hunter, and make his own weapons; or a shepherd, each household making its own clothing and raising its own food. But as soon as trade makes its appearance, specialisation has commenced. One man in the village does all the weaving, another does all the blacksmith's work, another all the carpentering, and so on.

3.—**Division of Labour**:—As trade grows, and producers work for larger markets, specialisation is carried further, and is called Division of Labour. The village blacksmith no longer makes the whole of his neighbours' ironwork; he confines himself to doing repairs and making horseshoes, while other iron goods are bought from large manufacturers. If we visit the establishments of these manufacturers, we find that the iron, in passing from the mine to the final consumer, is handled by a thousand workpeople, each doing some small portion of the work. Some tend the furnaces, some make moulds, some hammer, some file, some fit pieces together; and everyone keeps constantly to the same kind of work.

4.—**Effects of Division of Labour.**

(A) **On Production.** Division of labour increases effectiveness by the following economies:—

(1) Time is saved—
- (*a*) In learning, since each worker's task is simplified;
- (*b*) In working, since greater speed is attainable, and no time is lost in changing from one operation to another.

(2) Exertion is saved—
- (*a*) In learning;
- (*b*) In working. Greater skill can be acquired than would be possible without subdivision of tasks.
- (*c*) Machinery can often be constructed to perform a portion of the productive process.
- (*d*) Women, children, and comparatively feeble men may be employed for the less burdensome tasks.

Adam Smith thus illustrates these points: "To take an example, therefore, from a very trifling manufacture, but one in which the division of labour has been very often taken notice of, the trade of the pin maker, a workman not educated to this business (which the division of labour has rendered a distinct trade), nor acquainted with the use of the machinery employed in it (to the invention of which the same division of labour has probably given occasion), could scarce, perhaps, with his utmost industry, make one pin in a day, and certainly could not make twenty. But, in the way in which this business is now carried on, not only the whole work is a peculiar trade, but it is divided into a number of branches, of which the greater part are likewise peculiar trades. One man draws out the wire, another straights it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head: to make the head requires two or three distinct operations: to put it on is a peculiar business; to whiten the pins is another; it is even a trade by itself to put them into the paper; and the important business of making a pin is, in this manner, divided into about eight distinct operations, which in some manufactories are all performed by distinct hands . . . . (I have seen a manufactory where ten men were employed, who) could make among them upwards of 48,000 pins in a day. Each person, therefore, making a tenth part of 48.000 pins might be considered as making 4,800 pins in a day; but if they had all wrought separately and independently, and without any of them having been educated to this peculiar business, they certainly could not each of them have made twenty, perhaps not one, pin in a day; that is, certainly not the 240th, perhaps not the 4,800th, part of what they are at present capable of performing, in consequence of a proper division and combination of their different operations" (*W. of N.*, i., 1).

(B) **On the Labourer.**

(1) Division of labour relieves man of drudgery by permitting the employment of machinery.

(2) It has some tendency to monotony and narrowness of interest. Little that is worthy of a man is involved in learning and practising a very limited operation. But as against this there is the tendency for such operations to be performed by machinery.

(3) The construction and care of machinery afford scope for ability.

(4) The use of machinery facilitates change of trade. A man who has been brought up to the whole work of a particular trade may be thrown out of employment, and unable to find other work if his trade should fall slack. But a man who has been used to the machinery of one trade will commonly be able, with little trouble, to manage the machinery of another.

5.—**Machinery**.—The employment of machinery is in some cases an effect, in others a cause, of division of labour. When a man spends the whole day making a few simple movements, a machine for the same purpose easily suggests itself. On the other hand, when a machine is introduced the

production and the management of it bring about a further division of labour.

Machinery (1) increases man's command over nature. No application of muscular power could effect the operations carried out by such machinery as steam locomotives, steam hammers, &c.

(2) Relieves man of oppressive drudgery. "The jack-plane, used for making smooth large boards for floors and other purposes, was the worst enemy of the carpenter. All but specially-skilled men were compelled to spend a great part of their time with the jack-plane, and this brought on heart-disease, making them as a rule old men by the time they were forty. But now those who become prematurely old through over-work are to be found almost exclusively among the professional classes, among those engaged in the more anxious kinds of business, and in some agricultural districts in which the rate of wages is still very low and the people are habitually underfed." (MARSHALL, *Economics of Industry* [1899], 147-8, *n*).

6.—**Limits of Division of Labour.**—Increased Division of Labour usually involves an increased output at decreased cost per unit. As a rule it is not possible to obtain the advantages of the lower cost without increasing the output. We have seen from A. Smith's example that by division of labour ten men can turn out far more than ten times as much work as one man can, but the system is not often applicable to enable the same output to be obtained with less labour. This latter result, however, is not infrequently attained by an invention of machinery. The expense of production being decreased by division of labour, employers can afford to accept a lower price, and will usually have to do so, in consequence of the increased supply. But unless demand will increase in response to the fall of price, producers may find price go even below the reduced expense of production. This will necessitate a reduction of supply, effected by the retirement from the trade of the less capable producers. But demand may increase in response to the fall of price, enough even to temporarily increase the profits of the trade.

In many trades there are inventions waiting to be adopted which would decrease the expense of production per unit, but on condition of an output so much larger than any probable demand, at a remunerative price, that no one cares to run the risk of applying them.

7.—**Localisation of Industries.**—If an industry can be more profitably carried on in one place than in another, it will tend to become localised. This may result from several causes:—

(1) *Physical Conditions.* The extractive industries, *viz.*, those which merely take objects from their natural resting-place, such as deep-sea fishing, mining, quarrying, lumbering (wood-cutting in virgin forests), are necessarily localised according to the natural distribution of the objects sought. The case is similar with regard to productions dependent on local conditions of soil and climate.

(2) *Situation of Materials.* So if a trade, though capable of being carried on at different places, uses some material which is costly to transport, it will tend to become localised near to where such material is produced. Fuel and motive power attract many industries. At the end of the 18th century, water-power was applied to cotton-spinning, and this trade accordingly flourished in Derbyshire, Nottingham, and Worcestershire. From Roman times down to near the end of the 18th century iron-smelting was carried on in Sussex, with the aid of the wood supplied by the forests, portions of which yet remain. At the present time the textile and iron trades are localised in the North of England, to be near the chief coalfields.

(3) *Locality of Labour.* Sometimes an industry is established in a particular neighbourhood because suitable labourers can there be found. Prior to the comparatively recent introduction of machinery into the trade, cheap watches were made chiefly in Switzerland. The trade grew up there because of the existence of a scattered population of patient, ingenious, industrious people, the conditions of whose life gave them the opportunity of making the parts of a watch cheaply and well. On the other hand, a trade has sometimes been introduced into a district by the immigration of persons skilled in such trade. One of the best known examples is that of the immigration into England of Huguenot silk-weavers, in consequence of the Revocation of the Edict of Nantes in 1685. These weavers settled at Coventry, Spitalfields, and Macclesfield, and the trade thus introduced has been specially practised in those places down to our own

times. Although the places where such new comers settled down may have been selected for non-economic reasons, yet the trade having once been established in a particular spot, it could be more profitably carried on there than elsewhere. Children brought up in the vicinity of a localised industry are trained to such industry more easily than other children could be; there is usually a good supply of suitable labour on the spot; special skill is to be had. In addition, subsidiary industries grow up in the neighbourhood. Where an industry is localised, a footing can often be maintained by small factories which otherwise would be unable to keep pace with the large ones, in consequence of the advantages of the latter in (1) economy, (2) machinery, (3) buying and selling.

"On the other hand, a localised industry has some disadvantages as a market for labour, if the work done in it is chiefly of one kind, such for instance as can be done only by strong men. In those iron districts in which there are no textile or other factories to give employment to women and children, wages are high and the cost of labour dear to the employer, while the average money earnings of each family are low. But the remedy for this evil is obvious, and is found in the growth in the same neighbourhood of industries of a supplementary character. Thus textile industries are constantly found congregated in the neighbourhood of mining and engineering industries, in some cases having been attracted by almost imperceptible steps; in others, as for instance at Barrow, having been started deliberately on a large scale in order to give variety of employment in a place where previously there had been but little demand for the work of women and children." (MARSHALL, *Principles*, iv., 10).

8.—**Carrying Trades and Machinery of Exchange.**—The extension of the market which is usually a condition of division of labour makes necessary—

(1) Development of the carrying industry, since the product has to be distributed over a larger area. Such development is both a cause and a consequence of increased division of labour. The great economic feature of the 19th century has been the growth of means of transport, corresponding to the growth of machinery in manufacture which was the great economic feature of the 18th century.

(2) Development of the machinery of exchange, including the organisation of markets, and in particular that of the money-market.

9.—**Division of Labour and Exchange.**—"Division of labour is the necessary consequence of a certain propensity in human nature, the propensity to truck, barter, and exchange one thing for another." (*W. of N.*, i., 2). "It is because men first divide in production that they afterwards unite in exchange." (F. WALKER, *Political Economy*, Pt. 3, Ch. 1). Thus while Smith makes exchange the cause, Walker makes it the effect, of division of labour; but in fact there is no necessary connection between the two. In a socialistic, or slave-owning society, exchange might be almost or quite non-existent, while division of labour was largely practised. Plato extols the ancient Egyptians for turning to good account their knowledge of the value of division of labour, but the alleged absence of coined money from their institutions indicates that exchange was but little developed.

Where there is division of labour there must be *some* method of transferring products from producer to consumer. Under the present social order, Exchange, in its various forms, is the principal means whereby such transfer is effected.

10.—**Joint Stock Enterprise.**—It is a simple extension of ordinary business enterprise when several men join their efforts and capitals, in order to share the profits of the undertaking. This is called partnership. It is a further extension when the number of partners is increased to so large a number that it is impossible for all to share in the actual direction of the business, which is accordingly delegated to paid managers.

This we may call joint-stock production, which does not flourish unless the two following features are added—

(1) Any share-holder is at liberty to transfer his share to another person;

(2) The liability of each share-holder upon the transactions of the company is limited to a definite amount.

The advantages of the system are—

(1) A larger capital may be controlled by one will than would otherwise be possible.

(2) Large and continuous work may be better done than it otherwise could be.

(3) Some businesses, of which banking is a good example, are benefited by the large capital and the publicity which are more suited to joint-stock than to individual enterprise.

The disadvantages of the system are—

(1) The directors and managers have a less keen interest in the concern than if it were their own. Fidelity may be expected of them, but scarcely zeal.

(2) There is a tendency to disregard small gains and savings.

11.—**Agriculture.**—The nature of agricultural pursuits renders the application of division of labour less extensive than in manufactures.

The space which has to be attended to is large, and weather-conditions are important and variable. Machinery is, therefore limited in its application. It must be powerful and expensive, and will probably stand idle most of the year. Even where it is only hired by each farmer, changes of seasons and of weather will prevent great economy in its use. The same causes stand in the way of division of labour apart from the use of machinery. An agriculturist cannot, from the nature of the occupation, employ himself the year round in performing a particular branch of the industry, but must vary his tasks according to variations of crops, seasons, and climate.

Cultivation on a large scale involves higher organisation than does cultivation on a small scale. Nevertheless, better results seem to be obtained by the latter method in regard to certain crops, such as vines, olives, roots, legumes, and materials for manufactures, while the large system succeeds best in the cultivation of grain and forage.

12.—**Effects of Organisation of Industry.**—Higher organisation of industry makes trade more sensitive, but also more powerful both to resist and to recover from disturbances. A simple agricultural community may live on placidly for generations, but may be destroyed by a succession of bad harvests. An English workman of the present day may lose his occupation in consequence of a new invention, a war, a famine, or political changes, even in far-off countries.

But where division of labour is widely practised, parts of different trades are similar; and where markets are world-wide, they are not likely to be all depressed at the same time.

The function of managing industry becomes more important and more difficult to discharge efficiently, as the organisation of industry becomes more complex.

QUESTIONS AND NOTES.

1. Discuss the advantages and disadvantages of Division of Labour. (*Cert.*)

2. What do you understand by Division of Labour and Combination of Labour? Illustrate the economic advantages of both by reference to facts of modern industry. (*Cert.*)

3. Enumerate the principal advantages arising from the division of labour in the production of any article in common use. (*Cert.*)

4. Point out the chief advantages to be derived from division of labour, and indicate some of the limits beyond which such separation of employment ceases to be profitable. (*Cert.*)

5. Explain and illustrate the assertion that the division of labour is limited by the extent of the market. Point out benefits resulting from widely extended markets; point out also any drawbacks. (*Cert.*)

6. How does Division of Labour increase production? What, if any, limits are there to its application in practice? (*Cert.*)

7. Point out carefully in what way, and subject to what limitations, the use of labour-saving machines is beneficial to the labouring classes, and to the nation at large. (*Cert.*)

8. What in your opinion are the economical advantages and disadvantages of production on a large scale, in the case of (*a*) agriculture, (*b*) manufactures? (*Cert.*)

9. Show that division of labour is attended by certain disadvantages, and illustrate your statements by the results of improvements in machinery employed in agriculture. (*Cert.*)

10. In England the great industries are, to a large extent, localised in particular districts. Explain how this has arisen, and what are the advantages and disadvantages of such localisation. (*Cert.*)

11. What are the advantages and disadvantages of such a localisation of industry as we see, for example, in the woollen trade of the West Riding of Yorkshire, or the hardware trade of Birmingham and its locality? (*Cert.*)

12. Contrast the advantages and disadvantages of private and joint stock enterprise, with especial reference to the cases (*a*) of banks, (*b*) of co-operative stores, (*c*) of productive co-operation. (*B.I., Prel.*)

CHAPTER VIII.

CONSUMPTION.

1.—The consumption of wealth is the putting it to that use for which it is desired. Production is the creation of Utility; Consumption is the exercise of Utility. A picture is being consumed while it hangs on the wall; a nail is consumed

when it is knocked into a piece of wood; clothes are being consumed while worn, food when eaten. Consumption involves destruction of utility. Just as labour is creative, not of objects, but of utilities (iv., 2), so consumption is destructive, not of objects, but of utilities. Destruction of utility is consumption of commodity. The destruction may be rapid or slow; in some cases (diamonds, *e.g.*) it extends over vast periods of time.

The same material object may from time to time acquire and lose utility of various kinds. Thus the miner produces ore; the smelter consumes ore and produces pig-iron; the founder consumes pig-iron and produces ironmongery; the shop-keeper consumes wholesale parcels of ironmongery and produces goods by retail. The private house-keeper consumes ironmongery, but not for the purpose of producing wealth. His only object is to derive from the ironmongery that satisfaction which it is capable of yielding directly, and not by way of exchange.

This is its Utility when consumed unproductively.

2.—Productive and Unproductive Consumption.—We can now distinguish two modes in which a commodity may be consumed—

(1) For the purpose of producing wealth. This we shall call simply Productive Consumption. Wealth which is intended for such consumption is called Capital (vi., 1).

(2) For the purpose of enjoying the commodity's direct Utility. This we shall call Unproductive Consumption. In both cases there is destruction of Utility, but in Productive Consumption the object is the creation of other, and presumably greater, Utility, whereas in Unproductive Consumption the object is the enjoyment, not the creation, of Utility.

When Adam Smith said that "Consumption is the sole end of all production" (*W. of N.*, iv., 8), he referred to Unproductive Consumption, regarding Productive Consumption as part of the process of Production.

J. S. Mill speaks rather confusingly of unproductive consumption. He says that "whoever contributes nothing directly or indirectly to production, is an unproductive consumer. . . . . That alone is productive consumption, which goes to maintain and increase the productive powers of the

community, either those residing in its soil, in its materials, in the number and efficiency of its instruments of production, or in its people" (*Principles*, i., 3, § 5). It would be difficult, however, to say of anybody that he contributes nothing, even indirectly, to production. And it seems necessary, in determining whether consumption is productive or unproductive, to look, not as Mill does, to the actual result, but to the purpose or motive of the consumption. For the actual result is often accidental. Occupations pursued for mere amusement or disinterested study, sometimes prove highly productive of wealth; while, on the other hand, large quantities of wealth intended for productive consumption, frequently produce no fruit, in consequence of mishap or miscalculation, and their consumption is in fact unproductive.

We may illustrate the distinction by familiar instances. Is the cost of bringing up the child of a manual labourer consumed productively or unproductively? Our test is—does the father feed and clothe his child for the purpose of making a profit out of him? If so, the consumption is productive. But if he provides for his child out of natural affection or a sense of duty, the consumption is unproductive. Again, is a surgeon's consumption of pine-apple or opera boxes productive or unproductive? The same test applies. Does he eat pine-apple or visit the opera for the purpose of enjoying himself or for the purpose of increasing or maintaining his professional skill? If the latter, we may call the consumption productive. The same test is to be applied to beans and bacon as to pine-apples and opera boxes. Does the agricultural labourer eat because he is hungry, or in order to be the better able to do his master's work? If for the former reason, then his humble fare is consumed unproductively.

It may be well to go a little further in order to show the advantage of classing consumption as productive or not according to the *intention* and not the *result* of the consumption.

If I go fishing with the intention of getting a living by it, I consume boats, tackle, &c., and if I meet with storms and misfortune, a great deal of such consumption may be in fact unproductive. But I keep account of my losses by such storms and mishaps, and I expect my takings to cover them as well as that consumption of boats, &c., which has been more fortunate. And we shall see (ix., 11) that there is a relation

between the total Expense of production and the Value of any commodity. But if I go fishing for pleasure, I also consume boats, &c., and I may in fact sell some of the fish I get. In that case, however, there is no connection between Expense of production and Value. I may keep no record of my expenses, and, if I do, still I do not balance them against my takings. I should go on producing fish, although the value of the produce were less than sufficient to replace the waste of materials. These materials, then, are not Capital, since they are not intended to be consumed productively.

3.—**Consumption of Services.**—The services of the soldier, the judge, and most other agents of the State are not usually intended for productive consumption. They do in fact favour production, but only in the general way in which climate, &c., also favour production. The motive for the employment of State officials is not the economic motive—the desire of wealth. The same may be said of most "labour which relates to human beings" (iv., 5). Parents do not rear their children, nor does the State provide its subjects with the means of education, from the desire of wealth. All services, therefore, which are rendered for such purposes, may be said to be consumed unproductively.

Technical or Industrial Education provided by the State may be compared with improvements in roads and harbours, effected by the State for the general good of the nation. The intention is, no doubt, to further the production of wealth, but the motive is not the economic motive, since those who make the sacrifices are not necessarily those who are to benefit by them. The motive is political, not economic. The philanthropist who provides a poor workman with tools, by so doing assists in the production of wealth. Nevertheless his action is not due to the desire of wealth.

If an employer, however, should set up a school for the purpose of improving the intelligence of his workpeople for the benefit of his business, or if he incurs expenditure in training his staff for the same purpose, we may say that the services of the instructors are in this case intended to be consumed productively.

4.—**Consumption and Production.**—If Unproductive Consumption be unduly increased, Production will be checked. If the excess be in material commodities, there will be a lack of Capital, and "industry is limited by capital" (vi., 6). Leisure is analogous to Unproductive Consumption of Services, and excessive leisure will check production by lack of labour. If, on the other hand, Unproductive Consumption be unduly diminished, there arises the condition called "over-production." Thus a certain balance or proportion between Productive and Unproductive Consumption is necessary to the general welfare. No definite expression can be framed for such balance or proportion, but it may roughly be said that so long as capital can find profitable employment, saving (*i.e.*, Productive instead of Unproductive Consumption) contributes to the progress of material prosperity.

5.—**"Over-production."**—It is a much-debated question whether there can or cannot be "general over-production." The question turns on the relation between production and consumption, and may be stated thus—Can production outstrip consumption? For it is evident that if more goods are produced than are consumed, there is a state of over-production.

Now, if in "consumption" we include productive consumption, it would seem that there cannot be "*general* over-production." Suppose an increase in the production of houses which is alleged to be excessive; it is to be set off against the necessary corresponding increase in the consumption of building-materials and building-labour. The real question is, not Can production outstrip consumption, but Can production outstrip *unproductive* consumption? Let us suppose that our habits and customs suddenly alter: everybody gives all his attention to "business," and retrenches as far as possible every form of unproductive consumption, taking no more rest or leisure than is necessary to maintain working efficiency, rejecting all luxuries, all indulgences, and all gratification of any taste higher than that of making money. The first effect is a "glut" of all commodities except the necessaries of life and goods for productive consumption. Many classes of the latter are eagerly sought for: the energies previously expended on music, cricket, dancing, holiday-making, theatricals, &c., are now concentrated on building and running factories, getting better situations, advertising goods, scheming fresh enterprises, etc. There is great sudden prosperity of the building trades, the coal and iron and engineering industries, for business expansion needs houses and machinery. But how long will this state of things last? What goods can be

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Now, if in "consumption" we include productive consumption, it would seem that there cannot be "*general* over-production." Suppose an increase in the production of houses which is alleged to be excessive; it is to be set off against the necessary corresponding increase in the consumption of building-materials and building-labour. The real question is, not Can production outstrip consumption, but Can production outstrip *unproductive* consumption? Let us suppose that our habits and customs suddenly alter: everybody gives all his attention to "business," and retrenches as far as possible every form of unproductive consumption, taking no more rest or leisure than is necessary to maintain working efficiency, rejecting all luxuries, all indulgences, and all gratification of any taste higher than that of making money. The first effect is a "glut" of all commodities except the necessaries of life and goods for productive consumption. Many classes of the latter are eagerly sought for: the energies previously expended on music, cricket, dancing, holiday-making, theatricals, &c., are now concentrated on building and running factories, getting better situations, advertising goods, scheming fresh enterprises, etc. There is great sudden prosperity of the building trades, the coal and iron and engineering industries, for business expansion needs houses and machinery. But how long will this state of things last? What goods can be

manufactured by all these newly-rising establishments? If no one wears jewellery, those who have sunk their capital in the jewellery-trade will lose it. We have the ships, the wagons, the canals, the manufactories, but what are we to do with them? It is perfectly obvious that there will be a "glut" of all commodities, which could only be relieved by a return to larger unproductive consumption, either of Commodities, or in the form of Leisure. We conclude, then, that general over-production *is* possible. "Consumption is the sole end of all production," and therefore a balance is necessary between consumption and production. High productive efficiency implies great unproductive consumption, and a check to the latter involves a check to the former.

6.—**Law of Diminishing Utility.**—The law of Diminishing Utility in Consumption corresponds with that of Diminishing Return in Production (iii., 4). We might complete the comparison by stating a law of Increasing Utility corresponding with that of Increasing Return, thus: with regard to relatively very small quantities, an increase in the quantity of commodity consumed gives a more than proportional increase of satisfaction. For instance, to a starving man, two teaspoonfuls of beef tea would give more than twice the satisfaction that he would derive from one teaspoonful.

The important law, however, is that of Diminishing Utility. We will consider it first in reference to unproductive consumption.

Though a man could get any particular desired thing free of all expense, nevertheless he would not wish for an unlimited quantity of it, for two reasons:—

(1) Desire is satiable. The progressive satisfaction of a want tends to extinguish the want. Food is intensely desired by a hungry man; but with every mouthful after the first few his desire decreases, until at length he ceases to eat, though there be still plenty in the dish;

(2) When a man is occupied in satisfying one want, others are meanwhile neglected, become more intense in consequence, and tend to thrust themselves into notice.

John Gilpin, when indulging his taste for holiday-making, was neglecting his inclination to do business, which made itself felt as a check on the former.

"For saddle-tree scarce reach'd had he,
His journey to begin,
When, turning round his head, he saw
Three customers come in.
So down he came; for loss of time,
Although it griev'd him sore,
Yet loss of pence, full well he knew,
Would trouble him much more."

We may lay it down as generally true that an increase in a man's stock of any particular commodity is accompanied by a decrease in the keenness of his desire for more.

Imagine a farmer in a sparsely-peopled district going to the market town for a month's supply of general stores, and suppose that he knows pretty nearly what he will have to pay for most articles, but cannot foresee the price that he will be asked for some particular commodity, say tea. He will roughly frame in his mind beforehand a scale of his possible purchases of tea, thus:—"If I find tea at 10/- per lb., I will take 4lbs.; if I find it at 5/- per lb., I will take 6lbs.; if at 2/6, I will take 7lbs." We may interpret these three sets of figures as follows:—When the farmer's appetite for tea has been satisfied to the extent of 4lbs., the utility to him of a fifth lb. is less than the utility to him of 10/-; when his appetite has been satisfied to the extent of 6lbs., the utility to him of a seventh lb. is less than the utility to him of 5/-; and when his appetite has been satisfied to the extent of 7lbs., the utility to him of an eighth lb. is less than the utility to him of 2/6. Or we may put the same thing in another way, thus:—The utility to him of the fourth lb. of tea is equal to the utility to him of 10/-; the utility to him of the sixth lb. of tea is equal to the utility to him of 5/-; and the utility to him of the seventh lb. of tea is equal to the utility to him of 2/6, for otherwise he would buy more in each case. Price thus becomes a measure of Utility. We must be careful to note that Total Price does not measure Total Utility, but that Price per unit measures the minimum Utility of a unit. This latter quantity is called *Marginal* or *Final Utility*. To revert to our illustration of the farmer and his tea, we cannot say that the Total Price he pays for his month's supply of tea measures its Total Utility, for that would involve the absurdity of saying that the Utility to him of 7lbs. of tea (for which he

would be willing to give 17/6) would be less than that of 4lbs. (for which he would be willing to give 40/-).

In the case of Productive Consumption: since consumption is only undertaken for the sake of production, any diminution in the product will be the same thing as a diminution in the Utility yielded by the Consumption of the commodity. We have seen that the universal law of Production is that of Diminishing Return beyond the point of maximum efficiency. Such Diminishing Return of product is a statement from the point of view of Production of the same facts as, when stated from the point of view of Consumption, become the law of Diminishing Utility of the commodity whose consumption gives rise to the production.

Suppose our farmer is contemplating the purchase, not of tea, but of seed. He has found that 4lbs. to the acre gives a crop of 4cwt., 5lbs. gives 4½cwt., 6lbs. gives 4¾cwt. Further, he calculates that a quarter cwt. increase in the crop will just repay an extra lb. of seed at 5/- per lb. If, then, he finds seed at 4/6 per lb., he will take 6lbs. for every acre he means to sow, but if it is at 5/6, he will only take 5lbs. per acre.

Regarding his conduct from the point of view of Production, we say it is determined by the Law of Diminishing Return. Regarding it from that of Consumption, we say it is determined by Diminishing Utility.

7.—Forms of Consumption.—The destiny of a people depends chiefly on the way in which they consume their wealth. We may study—

(1) The amount "saved," *i.e.*, devoted to productive consumption.

(2) The nature of their unproductive consumption. There is the most intimate relation between Unproductive Consumption and Production. Unproductive Consumption is the sole end and purpose of all production. If it be reduced, production must be checked. High productive efficiency necessarily implies large unproductive Consumption. Every change in a people's culture makes itself felt economically as a change in the objects of unproductive consumption, and a corresponding change in production.

(*a*) Alcohol is a commodity whose consumption is so injurious to the individual and society, that great and sustained efforts have been made by philanthropists to discourage and diminish it.

(*b*) Schools, museums, pictures, &c., though consumed unproductively, yet may be expected to largely increase production indirectly.

(*c*) The introduction of new commodities, the creation of new desires, are powerful means of elevating a people. It has been said that the Spartans never rose to be civilised because they stifled their wants.

(*d*) Leisure may be regarded as a form of unproductive consumption. It implies that Services are consumed unproductively.

The question of Hours of Labour thus belongs in part to Consumption. From the point of view of Production, it is desirable that a labourer should work that number of hours which gives the greatest efficiency.

8.—Organisation in Consumption.—Consumption, as well as production, may be organised. Omnibuses, theatres, picture galleries, &c., are examples of consumption in common. The most successful form of Co-operation (xxiv.) is a case of co-operation in (not Production, but) Consumption.

QUESTIONS AND NOTES.

1. Can a valid distinction be drawn between luxuries and necessaries? (*Cert.*)

Luxury has been defined as that which can only be enjoyed by few (Condillac); a distinction which may be of importance in taxation. "Necessaries" is a relative term: "necessary"—for what? If it means necessary for enjoyment, no distinction can be drawn between luxuries and necessaries, since luxuries, however defined, may be necessary to some persons' enjoyment.

If "necessaries" means necessaries of bare existence, we may distinguish roughly between necessaries and non-necessaries. The Standard of Comfort or Standard of Life of any social class may be called "necessary," but would usually include more or less "luxury."

The terms, if they are to be used with precision, must be defined by reference to the purpose for which they are to be employed.

2. The present depression of trade and low level of general prices is sometimes attributed to over-production. In what sense, if any, can over-production be possible, and how far would it account for low prices and trade depression? (*B.I., Fin.*)

Over-production is the same thing as under-consumption. The question probably refers to Walker's opinion that general over-production is not possible, but that partial over-production is possible. This is otherwise expressed by saying that the wrong things have been produced: in certain lines production has outpaced consumption. The consequence is a fall of prices in those lines to an unremunerative level, followed by diminution of production, loss of employment and loss of capital. Depression thus produced in particular trades may spread to other trades (xvii., 3).

EXCHANGE.

CHAPTER IX.

VALUE.

1.—The greater part of the commodities with which we are concerned in Economics are produced in order to be sold and are bought in order to be consumed. As to these we may say that Exchange is the last event in Production and the first in Consumption, and that Production means placing on the market. But the Agents of Production are a peculiar case (xix., 3). And there are goods which are produced for the purpose of direct consumption, not for exchange (xix., 2).

It is the condition of division of labour that each producer shall do some *one* kind of work, not the innumerable different kinds which are necessary for the satisfaction of his own wants, and that the efforts of many individuals shall be combined to render any *one* commodity fit for unproductive consumption.

Organisation is therefore necessary (1) to co-ordinate the efforts of producers; and (2) to harmonise such efforts with the wants of consumers. It is by means of Exchange that such organisation is effected.

Under the head of Exchange we study—

(1) The terms of exchange. What forces come into play, and how do they act, to determine the quantity of a given commodity that will exchange for a given quantity of another? This inquiry is called the Theory of Value.

(2) The machinery of Exchange. How are exchanges effected? This includes the study of Markets, Competition, Money, and Banking.

The present chapter is occupied with the Theory of Value.

2.—**Value.**—We have defined Value as an attribute ascribed to a thing on the ground of the actual or possible exchange of that thing for some other thing.

3.—**Measurement of Value.**—The greater the quantity of another thing that can be obtained in exchange for a thing, the greater is the value attributed to the latter. In other words, we measure the value of a commodity by the quantity of any other commodity for which it will exchange.

4.—**Value not a Commodity.**—It is not accurate to say that the value of a commodity is the other commodity for which it will exchange.

If a hat sells for ten shillings, we say that the value of the hat *is* ten shillings, but the expression is elliptical. It means that the hat *has the same value as* ten shillings.

5.—**Value not a Ratio.**—Neither is it accurate to say that Value is a ratio. If a measurable quantity of one commodity exchanges for a measurable quantity of another, there is a ratio between the two quantities, and the quantity of either commodity is the measure of the value of the other. But the value is not the same thing as the ratio.

When a piece of metal has been weighed and measured, we state its weight and measure as ratios—it is so many times as heavy as the standard weight, so many times as long as the standard length-measure. But we regard length and weight as distinct from these ratios. Similarly with Value.

It will be convenient to usually employ the term Price in place of Value. Price is really a peculiar case of Value. The Price of a commodity is the quantity of money (which is a particular commodity) for which it will exchange. In a developed economic society money is employed in practically every exchange. Therefore, if we know the price of any commodity we can easily compare the value of that commodity with the value of any other. If a hat sells for 10s. and a pair of boots for 20s., we can regard two hats as being of equal value with one pair of boots. Price then is Measured Value.

6.—**General Rise or Fall of Prices.**—It is worth while to observe that while a rise or fall of all prices may, and occasionally does, occur, there can be no such thing as a rise or fall of all values. The latter proposition becomes evident on considering that if any thing has become *more* valuable as compared with another thing, the latter has to a corresponding extent become *less* valuable. If a quarter of wheat yesterday fetched 20 shillings, and to-day fetches 30, this fact may be stated either as a rise in the value of wheat, or a fall in the value of shillings.

A single commodity may become more or less valuable as compared with every other commodity. Suppose wheat goes from 20 to 30 shillings a quarter, and no other prices change.

General values are not altered, for by as much as wheat is increased in value compared with other commodities, by so much have other commodities decreased in value as compared with wheat. But suppose that the one commodity which thus varies in value as compared with all others is *money*. In that case there will be a general rise or fall of prices. Note that a rise in prices is a fall in the value of money, and that a fall in prices is a rise in the value of money.

7.—**Law of Demand.**—We have seen (viii., 6) that Price measures Final Utility, and that Final Utility is high when the quantity of a commodity taken is small, and low when the quantity taken is large. If now we define the Demand for a commodity as the quantity for which buyers make bids, we may say that the Law of Demand is that rising prices tend to reduce Demand, while falling prices tend to increase it. We must be careful not to say that Price and Demand vary inversely. That would mean that if Price fall to ½, Demand will be doubled, and so on. This *may* be the case in regard to a particular commodity (money, *e.g.*, x., 7), but it may not, and, in fact, it is not the case in regard to most commodities. For instance, when the minimum price of telegrams in Paris was reduced from one to half franc, the demand increased tenfold.

8.—**Effective Demand.**—The mere *desire* of buyers has no effect on value; it must be supported by a bid of a price, and is then called Effective Demand. By Demand simply we shall always mean effective demand. We may distinguish between the "intensity" of Demand, *i.e.*, the height of the price which is bid, and its "extensity," *i.e.*, the quantity asked for. But inasmuch as Price measures intensity, we may use "Demand" simply, as above defined, for "extensity" alone.

9.—**Supply.**—We have not yet stated a complete Theory of Value, for hitherto we have only considered the conditions of Demand, and have neglected the equally important conditions of Supply. The Supply of a commodity is defined as the quantity offered for sale.

10.—**Monopoly.**—It is not necessary at present to consider whether there is only one buyer or are many. The Law of Demand, stated generally, is the same in either case. It is

true of a single buyer, as a rule, that if price be high, he will buy less, and if low, he will buy more. And this is *a fortiori* when there are many buyers. But in respect of Supply, it is necessary to distinguish whether there is only one seller (or what comes to the same thing, a combination of sellers under the control of one will), or whether there are several sellers in a state of competition.

The single seller (whether one person or a combination) is said to have a Monopoly. The monopolist has supply entirely under his control, and can fix it at his pleasure. He can also fix Price at will. But he cannot fix both Supply and Price arbitrarily. He must determine one, and the other will thereupon be determined by buyers in accordance with the law of Demand. If he offer a large supply he can get only a low Price. If he fix the price high, he will be able to sell only a small quantity.

His object being to make as large a total profit as possible, he may find either course to his interest. If a fall in price will induce but a small increase in demand, the monopolist will prefer small sales at high prices. Thus the Dutch, when they had the monopoly of the East India spice trade, are said to have destroyed part of the crop in seasons of unusual abundance. Had they put the whole crop on the market, the price would have fallen so low that their total profit would have been less than on the smaller sales at high prices.

If on the other hand, a small drop in price will largely increase Demand, the monopolist may be willing to sell as cheaply as though there were competition. The Standard Oil Company has practically the monopoly of the petroleum output of the United States, but finds a low price stimulate consumption to such an extent that its interest lies in keeping price down.

11.—**Competition and Expenses of Production.**—We now proceed to consider the laws of Supply that prevail when there is competition among sellers. The first law to be noted is that competition tends to equalise Price and Expense of Production. If Price happens to be much higher than Expense of Production, sellers make unusually large profits, and are thereby induced to increase Supply. The effect of such increase is, in accordance with the Law of Demand, to reduce Price.

On the other hand, if Price happens to be lower than

Expense of Production, sellers lose by the trade. They therefore restrict Supply, and then, in accordance with the Law of Demand, Price can be raised.

12.—**Laws of Supply.**—We can now state three laws of supply, which express the effect on value of the laws of return (iii., 4).

(1) The expense of production of a commodity which is produced under conditions of Constant Return is the same per unit of commodity, whether much or little is produced. Since Expense of Production cannot vary, Price cannot vary. It will be necessary to make Supply equal to the Demand which will be called forth by a Price equal to the Expense of Production In this case, Expense of Production determines Price, Price determines Demand, and Demand determines Supply.

(2) In the case of a commodity which is produced under conditions of Diminishing Return, Supply can only be increased at an increased expense of production per unit.

Supply will determine Expense of Production; Expense of Production will tend to be equal to Price; Price will determine Demand. (*a*) If the Demand thus determined be not equal to the Supply, Price will be affected. If Demand be greater than Supply, Price will rise, permitting an increase of Supply. (*b*) If demand be less than Supply, Price will fall, necessitating a diminution of Supply.

(3) In the case of a commodity which is produced under conditions of Increasing Return, Supply can be increased at a decreasing expense of production per unit.

Supply will determine Expense of Production; Expense of Production will tend to be equal to Price; Price will determine Demand.

If the Demand thus determined be not equal to the Supply, Price will be affected. (*a*) If Demand be greater than Supply, it can be satisfied at a lower Price, since a greater Supply may be produced at a lower Expense per unit. Price, therefore, will rise temporarily during the temporary shortage of supply, but will subsequently fall when the conditions of increasing return come into play. (*b*) If Demand be less than Supply, Price will fall; but what will be the result of that fall? It may cause either (i.) a diminution in Supply, with a consequent rise in Expense of Production and therefore in Price, which will still further check Demand,

or (ii.) an increased Supply at a lower Expense of Production and Price: the fall in Price may call forth a Demand equal to the Supply at the lower Price.

13.—**Joint Production.**—In some cases two or more commodities are produced by one and the same process, *e.g.*, wheat and straw, gas and coke, mutton and wool, and all "by-products." In such cases the expense of production of the joint products tends to be equal to the sum of the prices of both. But how are their values with reference to each other regulated? Producers will endeavour to sell them in the same relative quantities as they are produced. If at given prices, total price repays expense of production, but there is difficulty in getting rid of the whole of one of the commodities, the price of the latter will be slightly lowered and sales stimulated, and that of the other slightly raised and sales checked. Briefly, the commodities being produced in a certain ratio, their prices must be such as to cause a demand for them in the same ratio.

14.—**Alternative Demand.**—The demand for any commodity is influenced not only by the price of that commodity, but by the price of others. This relation is most striking in the case of groups of commodities which can to some extent replace each other in consumption: *e.g.*, tea, coffee, cocoa; beef, mutton, pork; wool, linen, cotton, silk. If the supply of one member of such a group should be diminished, the rise in its price will be checked by the transfer of part of the demand for it to the alternative commodities, whose price will also tend upward in consequence. Similarly, an increase in the supply of one member of a group will tend to force down the price not only of that member, but of all the members of the group.

15.—**Normal and Market Value (or Price).**—Market Price is the actual price realised in a market. Normal (or Natural) Price is that price towards which market prices constantly tend. If market price be so low that sellers lose on the transaction, supply will be reduced and price will rise; if it be so high that extraordinary profits are made, supply will be increased and price will fall; if it be such as to give the profits which are usually expected in the trade, it is Normal, and there is no tendency to change. As thus defined, Normal Price is measured by Expense of Production.

Normal price rarely coincides with Market price—

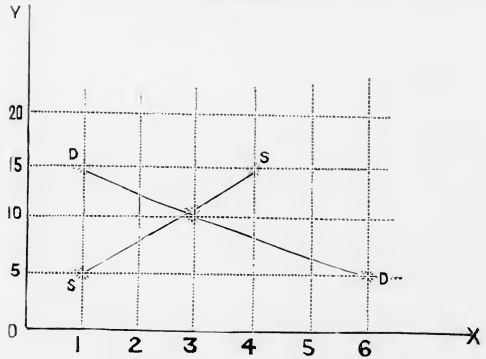
(1) The operations of production have to be begun, in many cases, long before the commodity can be put on the market, and under such circumstances that no exact calculation can be made of the effect on price of the supply that is being produced.

(2) Many commodities are liable to deterioration, and cannot therefore be held back. But large quantities of such goods are often destroyed, rather than sold at low prices. Supply varies with seasons, &c.

(3) Where a trade employs large fixed capital, price may for long stand above expense of production, before an employer can be found to take the risk of starting a new business; and on the other hand, when price falls below expense of production the great loss involved in closing the works will often induce employers to continue to produce at a loss.

(4) Custom and Habit are powerful in some, especially the retail, markets.

6.—Diagrammatic Representation of Theory of Value.



Let equal distances on o x represent millions of tons of coal. Let equal distances on o y represent shillings. Suppose that at 5s. per ton sellers will be willing to sell one million tons;

at 10s. three million tons; at 15s. four million tons. We may represent these figures by points on the diagram in the line s s, which is called the "supply curve." Further, suppose that at 5s. per ton buyers will be willing to take six million tons; at 10s. three million tons; and at 15s. one million tons. We represent these figures similarly, by points in the line d d, called the "demand curve." The point of intersection of the two curves indicates the quantity which will tend to be bought and sold, and the price which will tend to be paid. The price will be "market" or "normal," according as the curves are curves of "market" or "normal" supply and demand.

The student should construct curves illustrating the various cases of value.

QUESTIONS AND NOTES.

1. State and illustrate the operation of the Law of *Demand* and *Supply*. How is it modified in the case of a *monopoly*? Define carefully the words in italics. (*B.I., Prel.*)

2. Define the terms Utility, Marginal Utility, Demand. Carefully explain the relation between Demand and Price, and show the way in which this limits the power of monopolists to raise prices. Illustrate your answer from the case of coal. (*A.S. of Taxes.*)

3. Explain the way in which a monopoly price is determined, taking as an illustration, railway rates, both for goods and passengers. Are we justified in assuming that the price which will give the greatest profit to the monopolist is necessarily higher than the price which would result from unlimited competition? (*B.I., Fin.*)

4. What is generally understood by the "natural value" of any article? Show that the value of all things that cannot be indefinitely increased is governed by demand and supply. (*Cert.*)

The value of *all* commodities is governed, directly, by demand and supply. If demand increases (which means that at the same price as previously obtained, buyers are willing to take more than they previously have done) price rises, and if demand decreases, price falls. If supply increases, price falls, and if it decreases, price rises. "Things that cannot be indefinitely increased" should mean commodities produced under conditions of Diminishing Return, but it probably refers to things whose supply cannot be increased at all. In this case, Expense of Production cannot affect value. The value of a particular thing is never affected by *its* expense of production. It is the expense of producing similar things that indirectly affects its value, by influencing Supply; *e.g.*, suppose that while there is on the market a large stock of bicycles which cost £5 each to make and are selling at £6, a bicycle-making machine is invented capable of turning out bicycles at a cost of £3 each, and the owner offers bicycles as good as the existing stock at £4 each. If he can supply the demand called forth by the price of £4, holders of the old stock can not get more than that price for their cycles, which they will

therefore be obliged to sell at a loss. Hence it has sometimes been said that Value depends on Cost (meaning Expense (iii., 3) not of Production, but of Re-production. But this verbal correction is not needed if the doctrine of Expense of Production is properly understood.

5. A celebrated horse was lately sold for 15,000 guineas; an ordinary riding horse can be bought for say £50. Explain by what laws respectively the value is determined in these cases. (*Cert.*)

6. "The proposition that the normal price of a product is equal to its cost of production is under certain assumptions a true statement; but it is in almost all cases an insufficient one." State the assumptions, and show why the proposition requires to be supplemented. (*A.S. of Taxes.*)

7. In what sense, and under what conditions, can the value of a commodity be said to be determined by its cost of production? Illustrate your answer by reference to the cases (*a*) of gold, (*b*) of English wheat, (*c*) the daily newspaper. (*B.I., Prel.*)

8. "The first effect of increased demand is to raise prices, the ultimate effect is to lower them." Carefully explain what you mean by "Increased Demand," and generally examine on what conditions the above statement would be true. (*B.I., Prel.*)

9. Explain and illustrate the economical terms:—Cost of Production, Effective Demand, Normal Value, Market Value. What causes the Market Value of a commodity to undergo rapid changes, even while its Normal Value is constant? (*Cert.*)

10. Distinguish between the Normal and the Market Values of a Commodity, and explain concisely how each is regulated. (*Cert.*)

It is said by F. Walker that (1) Market Value is determined by Final Utility, while (2) Normal Value is determined by Final Sacrifice (or Dis-utility). (1) If a definite quantity of goods is actually put on the market and sold "without reserve" (*i.e.*, all sold at the best price they will fetch), price is determined simply by the Final Utility of that quantity to buyers. If a "reserve" (price below which sellers refuse to sell) is fixed, then such reserve, if it comes into operation, determines Final Utility, and the state of demand will determine the quantity of goods that will be sold. (2) Normal Price tends to be equal to Expense of Production. Different portions of the supply are produced at different expenses (xix., 6). The normal price must be sufficient to repay the expense of production of that portion of the supply which is produced at the greatest expense. We may assume that the greatest expense of production corresponds to the greatest cost of production, and such Cost is called Final Sacrifice or Dis-utility. The least-favoured producer ceases production when he judges that the price he will get for the portion of his output which is produced at the greatest sacrifice will no more than repay that sacrifice.

11. Distinguish between Normal and Market Value, and show how they are connected. What circumstances affect normal price? How is it influenced by changes in Supply or Demand? (*B.I., Prel.*)

12. Give an analysis of the chief causes of fluctuations in Market Values. What circumstances have in recent times tended (*a*) to diminish, (*b*) to increase these fluctuations, and on what Values have they operated respectively? (*B.I., Fin.*)

13. Define the economical terms:— *value, market value, natural value,* and *price.* Why cannot there be a general rise or fall of *values,* but can be a general rise or fall of *prices?* (*Cert.*)

14. How is the value of a commodity determined which is produced as incidental to the production of some more important commodity, *e.g.*, molasses in the production of sugar, straw in the production of wheat? (*Cert.*)

15. How far and in what way does cost of production contribute to determine price (*a*) where there is competitive production, (*b*) where there is monopoly, (*c*) where two commodities may be used as substitutes for one another? (*B.I., Fin.*)

16. What is Value, and on what does the value of a commodity depend? Distinguish, with examples, Value from Utility; Value from Price. Examine the assertion, "Value is inherent only in services." (*Cert.*)

We have seen that the value of a thing is always relative. But the attempt has sometimes been made to conceive a Real or Absolute or Ideal or Natural Value. Thus Adam Smith thought that "the nature of things has stamped upon corn a real value, which cannot be altered by merely altering its money price . . . . That value is equal to the quantity of labour which it can maintain . . . . The real value of every other commodity is finally measured and determined by the proportion which its average money price bears to the average money price of corn" (*W. of N.*, iv., 5). This makes labour an absolute measure of value; but we have seen that no exact comparison can be made of different kinds or quantities of labour.

In a vague way we may trace back Value to Labour by observing that Production always involves Labour, and that Capital may be regarded as a sort of crystallised Labour.

But these remarks throw no real light on the questions raised under the head of Value.

17. Carefully explain what is meant by the Equation of Demand and Supply. Are any general truths known in regard to the way in which demand varies with variations in price? (*B.I., Prel.*)

18. What economic causes affect the price of goods? Discuss the probability of an increase or decrease in the prices of:—ivory, motor cars, bricks, horses, early editions of Shakspeare. (*L.C.C., Jun.*)

19. In the year 1898 a war broke out between the United States and Spain: shortly afterwards there was a sudden rise in the price of wheat in England. Explain the connection between the two events. (*L.C.C., Jun.*)

CHAPTER X.

MONEY.

1.—**Barter.**—The primitive form of exchange is Barter, the direct exchange of any commodity for any other commodity. Its inconvenience lies in the "double coincidence of wants and possessions" which it requires. The man who has a canoe to spare and wants a spear cannot satisfy his desire by means of exchange until he meets with another who wants a canoe and can spare a spear.

2.—**Money.**—The government of a country in which barter was practised might greatly facilitate exchange by issuing pieces of paper stamped with various figures (1, 2, 5, &c.), and enacting that no one else should issue such papers, and that the papers should exchange for each other and for other commodities in the ratios of the impressed figures. If, when such papers were in universal use, it became known that a canoe usually exchanged for [100], and a spear for [50], then the man who had a superfluous canoe might at once sell it for [100], and with this could buy a spear, receiving also [50] to make up the value of [100]. The necessity of "double coincidence" would be avoided; the man who bought the canoe might not have a spear; the man who sold the spear might not want a canoe. Further, the respective values of canoe and spear could be more exactly compared and adjusted than was possible by barter.

3.—**Evolution of Money.**—The pieces of paper above described would be money. But historically, perhaps, no such case as we have imagined has ever occurred, although paper money seems to have been known in China in the 9th century. The substances most widely employed as money at the present time are gold and silver, which have come to occupy that position by a process which we may sketch as follows:— Silver (to speak for convenience of that only) was first desired as an ornament, and anybody who had a surplus of other commodities was willing to barter such surplus for it. It would follow that anybody who had a quantity of silver by him and needed other commodities could usually obtain such commodities in exchange for his silver, which would thus tend to be used, not only as an ornament, but also as a store of value. Persons having a surplus of goods at any time would exchange them for silver as a means of providing for future wants. It is only an extension of this practice to effect all exchanges by means of silver, or, in other words, to employ silver as money.

4.—**Qualities of Money.**—The qualities or attributes which it is desirable that money should possess may be thus stated:—

(1) *Value.* This is implied in the fact that money is exchanged for other commodities, and it implies that money has Utility. The only utility of paper-money is that of

effecting exchanges, and it has a negligeable expense of production. Most of the objects used as money, especially gold and silver, are sought after for other purposes as well, and have a substantial expense of production.

(2) *Portability.* On the one hand, money should be as light and portable as possible, and, on the other, it should not be inconveniently small. It is said that Lycurgus obliged the Lacedaemonians to use iron money in order that its weight might deter them from trading. In the 18th century copper money was used in Sweden, and merchants had to carry it in wheelbarrows. The demand for and supply of gold have hitherto been so related as to give great value in comparatively small bulk. Gold or silver can be carried between London and Paris and insured for about 8s. per cent., and between London and any part of the globe for from £2 to £3 per cent. For small amounts gold is too valuable. A gold penny would weigh only half a grain.

(3) *Durability.* A sovereign, which weighs about 123·27447 grains when fresh from the Mint, is reduced by fair wear and tear to 122·5 grains in from 15 to 20 years. When it weighs less than 122·5 grains, it ceases to be legal tender. With equal wear, small coins lose a greater proportion of their weight than large coins do.

(4) *Homogeneity and Divisibility.* Metals and alloys may be made almost absolutely uniform in quality; they can be divided with ease and accuracy, and can be re-united with little loss. Slaves and cattle, which have been employed as money, and precious stones, which are sometimes used as a store of value, are lacking in these qualities.

(5) *Stability of Value.* The durability of gold and silver prevents fluctuations in the supply of those metals from rapidly affecting their values, since the total stock in existence is large compared with the annual production. The world's stock of corn is rarely more than half as large again as the amount of the annual harvest, whereas the world's stock of gold and silver is perhaps fifty times as large as the annual production.

(6) *Cognizability.* "The capability of a substance for being easily recognized and distinguished from all other substances." To successfully counterfeit gold or silver coins is very difficult.

Paper-money possesses the above-named qualities in the highest degree. Its value is entirely under the control of the

issuer (x., 7), and *might* be kept more stable than that of any other kind of money. It wears well, and can be cheaply replaced. In portability, divisibility, and homogeneity it may be considered perfect, while it may be so manufactured as to render counterfeiting even more difficult than in the case of gold and silver.

5.—**Functions of Money.**—(1) The fundamental and defining function of money is that of acting as the Medium of Exchange. We may define money as a commodity which is universally accepted in exchange for all other commodities, with no intention on the part of the receiver to use it in any other way than to effect further exchanges.

From this it follows that money is (2) a Measure of Value. F. Walker prefers to call this function that of the Common Denominator in Exchange, for the reason that Value is a Ratio, and a ratio can be expressed, but not measured. As to this see ix., 5.

(3) Money is a Store of Value.

(4) Money is sometimes said to act as a Standard of Value, or Standard for Deferred Payments.

Loans are of two kinds; (1) where the actual thing lent is to be returned, as the loan of a bicycle; (2) where a certain quantity of a certain commodity is delivered, and the same quantity of the same commodity is to be returned. If Alpha lends Beta £10, Beta need not pay back the same coins that he received.

When money is lent, the real object of the parties is that the same quantity of "purchasing-power" shall be returned as was advanced. Money, then, is regarded as a Standard of Value; *i.e.*, lender and borrower assume that the same quantity of money will have the same purchasing-power at the period of repayment as it had at the period of advancing the loan.

6.—**Money a Commodity.**—If I sell a horse for £20, and with the money received for the horse buy a bicycle, I may regard the transaction as in effect an exchange of the horse for the bicycle. In that view, the money is merely the *medium* of exchange. But money is itself a *commodity*. The sale of the horse is itself a complete exchange, not half an exchange. The value of the horse equals the value of the £20. Money is a commodity having value, which is determined in accordance with the general laws of value.

7.—**Value of Money.**—When, therefore, we speak of the value of money, we shall use the expression in the same sense as when we speak of the value of any other commodity. It rises as the quantity of commodities for which a given amount of money will exchange increases, and falls as such quantity decreases. Thus it is indicated by the general level of prices, and varies inversely as such level (ix., 6).

But "value of money" is also popularly used in two other meanings:—(1) The Rate of Interest; the price of the extended loan of purchasing-power; (2) The Rate of Discount; the price of the temporary use of legal tender. This is the sense in which money is said to be "cheap" or "dear" in the "City."

The value of money, as of all other commodities, is determined immediately by Demand and Supply, Expense of Production only affecting Value through Supply. Paper-money is always issued by a monopolist, usually the Government, which having the Supply entirely under control, can regulate Value at will. The issue of gold and silver money is now also a Government monopoly in most countries, and therefore the value of such money may be greater, to any extent, though of course it can never be less, than the value of an equal weight of uncoined metal of the same quality.

Gold and silver are produced under conditions of Varying Return. A discovery of rich deposits, or of better methods of working, produces the effects of Increasing Return; the exhaustion of known deposits produces the effects of Diminishing Return. The production of these metals will be extended until Diminishing Return raises the Expense of Production, estimated in the metal produced, to equality with the quantity produced; *e.g.*, an ounce of gold being worth £3 17s. 10½d., the production of gold will be pushed until at the least productive mine it costs £3 17s. 10½d. to produce an ounce of the metal.

Thus the laws of Supply apply to money as to other commodities. Paper-money has a purely monopoly-value. Gold or silver money depends for its value chiefly on the value of the metal contained in it. We have seen that the supply of such metal is governed by expense of production; but the total stock of the metal is so great in comparison with the annual production that variations in production at the mines influence the value of the metal but slowly.

We now proceed to consider the law of Demand for Money. We have seen that together with an increase in a man's stock of any particular commodity, there goes as a rule a decrease in the intensity of his desire for more. It would seem that this rule does not apply to Money, for the following reasons:—

(1) Money, *as such*, is desired only for the sake of the things it will procure, and the quantity of things that may be thus procured has no fixed relation to quantity of money.

(2) Money represents, not one particular form of satisfaction, but all forms. I desire a certain quantity of money in order to procure food. When I have enough for that purpose, my desire for food-money is satisfied, but I desire money none the less on that account, because, having food, I want clothes, luxuries, social distinction, philanthropic activity, and all these desires may be satisfied, in part at least, by means of money. The result of this Constant Utility is that whatever the Supply of money may be, the whole of it is taken by those who put forward an effective demand for money, or in other words, offer commodities for sale. We may satisfy ourselves that this really happens, by reflecting that money *must* be either transferred or hoarded, and that the latter practice is almost entirely disused in England at the present day.

The Demand for money is the whole quantity in circulation, irrespective of the value of money. Whether that value be high or low, the demand is for the whole of the money. The Supply of money is the same as the Demand, *viz.*, the total quantity in circulation. There never is, therefore, that discrepancy between Supply of and Demand for money which sometimes occurs in the case of other commodities. and produces variations between Market and Normal Price. The latter distinction, consequently (*viz.*, that between Market and Normal Value) does not apply te money.

Changes in the value of money are measured by changes in the general level of prices. An increase in the quantity of commodities put on the market tends to raise the value of money, *i.e.*, to lower prices. An increase in the quantity of money tends to lower its value, *i.e.*, to raise prices. The rise or fall is directly proportional to the increase which causes it. If commodities on the market double in quantity, prices fall to half; if money doubles, prices double. And the same, *mutatis mutandis*, of a decrease.

8.—**The "Quantity Theory."**—In order to obtain a clear notion of the way in which the general level of prices is determined, let us begin by excluding everything savouring of Credit, and let us suppose that money is not permitted to be paid at any other hour than at the stroke of mid-day. There being no credit, sales take place only in the morning and are completed at noon. Each person finds it necessary to keep by him a reserve of coin, to meet the probable excess of payments over receipts on any given day. If general prices are high, this reserve will be greater than if prices are low, but whether prices are high or low, the reserve will bear the same proportion to the total of his receipts and payments. Out of the total of the circulating medium of the country, then, it is necessary to allow for a proportion which has to be kept idle by way of reserve against contingencies.

This deduction made, we may say that the value of all goods changing hands on any given day equals the value of the whole of the money in the country. If the quantity of goods and the quantity of money should vary in the same ratio, the level of prices would remain stable. But if those quantities should vary in different ratios, the level of prices would alter; *e.g.*, if the quantity of goods offered for sale to-day were double the quantity offered yesterday, quantity of money being the same as yesterday, there would be a sharp fall in prices to a half of what they were yesterday.

Let us notice a possible case. Suppose that a number of persons, not previously engaged in trade, become "middlemen," whereas there had hitherto been no such occupation known. They buy up goods to sell again in the same condition. There is no increase in the quantity of commodities in existence, no increase in the satisfaction obtainable by the consumption of goods, nevertheless a greater quantity of commodities will be offered for sale each day, since the same commodities will come into the market more frequently than before. The general level of prices will have to fall.

It seems to have been imagined by certain writers that, as in this case, prices fall because the same goods are offered for sale more frequently than before, so some manipulation of money (apart from any form of credit) is possible, by which prices may be raised, the same money coming on the market more often than it had previously done. Such a change they describe as an increase in the "rapidity of circulation" or the "efficiency of money" (J. S. Mill).

It seems impossible, however, to imagine any alteration in business habits which would have such an effect, excepting the abolition or diminution of a practice of hoarding, or the adoption of some form of credit.

We now vary our imaginary illustration by supposing that all the money (metallic) in the country is deposited in a bank, and bank-notes issued to the same nominal amount. When a man pays away a £5 note, he transfers his right to five sovereigns, which, fraud and accident apart, actually exist at his disposal. There is here no "Credit" properly so-called, and prices remain unaffected. Next, we suppose that the note-issue is doubled, everything else remaining the same so far as possible. Under these circumstances, when a man pays away a £5 note he transfers a right to five sovereigns which, fraud and accident apart, do *not* exist at his disposal. There are only 2½ for him. Here is "rapidity of circulation" indeed. Two persons may simultaneouly transfer the right to the same coin. But there is also a form of Credit. If the quantity of goods offered for sale remains the same, prices will double; or double the quantity of goods may be dealt in at the same prices as previously.

9.—**Rapidity of Circulation.**—In effect, under the circumstances supposed, each coin lying in the Bank does double the work that it did previously. We therefore adopt the expression "rapidity of circulation" to express the effect of credit and banking in economising the use of metallic money The chief means by which such economy is effected are:—

(1) Reduction of hoarding.

(2) Use of credit instruments.

(3) Banking: (*a*) Organisation of dealings in money; (*b*) Economy of banking reserves.

In London the money handled by bankers consists on the average of about ·5 p.c. coin, 1·5 p.c. bank-notes, and 98 p.c. cheques and bills. These figures indicate great economy of gold in the English system.

QUESTIONS AND NOTES.

1. Distinguish between the various senses in which the phrase *value of money* is used; and point out in each case the proper measure or index of the value in question. (*B.I., Prel.*)

2. Explain the ways in which utility, cost of production, and exchange-value are related; and apply your results to the case of money. (*B.I. Prel.*)

3. *Rapidity of Circulation* is thus defined by J. S. Mill (*Principles*, iii., c. 8, § 3). "The amount of goods and of transactions being the same, the value of money is inversely as its quantity multiplied by what is called the rapidity of circulation." This only applies "to a state of things in which money, that is, gold or silver, is the exclusive instrument of exchange, and actually passes from hand to hand at every purchase, credit in any of its shapes being unknown." Statements to the same effect are made by Prof. Nicholson (*Money* [1897], 63-4, 147, 383), and others.

It is easier to follow the meaning of those writers, who connect the notion of "rapidity of circulation" with credit-operations.

"A given quantity of the precious metals is made to do infinitely more work by means of banks than it would do if there were no banks." Giffen, *Essays in Finance*, ii., 106 (1887).

If a banker "discounts with that portion of his banking capital which is raised by deposits, he does not increase the amount of the currency, but gives it increased rapidity." Gilbart, *Banking*, i., 129, 141 (1882).

5. What is *money?* State concisely the qualities required in a substance used as money. What different meanings are attached to the term "*value of money*"? (*Cert.*)

6. In what different senses is the term "the value of money" employed? Examine into the connection and difference between these various senses. (*A.S. of Taxes.*)

7. Account for the well-known ambiguity in the phrase "value of money." In what cases may "cheap money" make "cheap capital"? (*A.S. of Taxes.*)

8. Explain the quantity theory of money. How is it modified in actual circumstances in the case of metallic money, and how is it affected by the use of credit? Does the value of metallic money conform in any degree to cost of production? (*B.I., Fin.*)

9. Explain and distinguish the different senses in which the term *value of money* is used. "How can gold be scarce when the market rate of discount averages 1 p.c?" "Money is generally cheap to borrow when it is dear to buy." Discuss these positions. (*B.I., Prel.*)

10. Show that gold and silver are marketable articles, whether as coin or as manufactured goods. Why are they suitable for small transactions? How is their place supplied in larger transactions? (*Cert.*)

11. *Bank-notes and Cheques.* We define money as the "medium of exchange." Refer to the illustration (xi., 6) of Alpha and Beta and the bill of exchange. The bill there is used as the medium of exchange. A cheque, being a bill of exchange (xi., 4), may therefore be used as money. So, of course, may a bank-note. It thus appears that a credit-document may be money. F. Walker seems to think that if a document is a Credit, it cannot also be money. He says that bank-notes are money, because in so far as they are credit, they are so only as between holder and issuer, whereas the question "money or not" depends on their relation to payer and receiver, between whom they are not credit. But he denies that cheques are money, "simply because cheques are a form of credit, both between the holder and the issuer, and between the buyer and the seller (*i.e.*, the payer and receiver of the cheque); while, between the buyer and the seller, the bank-note, as has been remarked, is, in effect, final payment" (*Money*, 1888, pp. 398-9).

CHAPTER XI.

CREDIT.

1.—**Lending.**—If Alpha lends Beta a field or a house or a bicycle, whether gratuitously or not, we do not usually employ the term "credit" to describe the transaction. But if he sells or lends Beta something and agrees to wait for payment of the price, or if he lends Beta a sum of money, whether at interest or not, he is said to "give credit."

2.—**Credit and Debit.**—Alpha has a legal Right to receive payment of the agreed sum at the agreed time, which is called a Credit, and Beta lies under a corresponding Duty or Liability to make such payment, which is called a Debit or Debt.

If Alpha has lent Beta £1000 at 5 p.c., Beta may lay out the money in machinery, or wages, or materials, which will belong absolutely to him. It will not be possible for Alpha to point to any of such things and say "That is mine, but I permit you to use it." The interest, then, is not paid for the loan of the things bought with the borrowed money, but is paid as an inducement to the lender to give time to the borrower for repayment. When we say that Interest is payment for the use of Capital, or speak of "lending" money, we seem to imply that the capital or money in question belongs to the lender, who permits the borrower to make use of it.

But when money is lent, the debt subsists though the borrower become penniless. A Credit is a legal Right, a Debt is the corresponding legal Liability.

3.—**Good and Bad Credit.**—"Credit" is used in a different sense when we speak of a man's credit being good or bad, high or low. This means that others are willing or unwilling to give him credit, *i.e.*, to exchange their commodities for his Debt, his legal Liability. In this sense of the word, "credit" means reputation for solvency, or ability to meet all legal claims.

4.—**Transfer and Forms of Credit.**—Alpha can transfer his Credit to any third person. But Beta cannot transfer his Debt to a third person without Alpha's consent.

Different modes and conditions of the transfer of Credits give rise to what are called various "forms" of Credit. These may be thus classified:—

(1) Book-debts.
(2) Promissory notes and bank-notes.
(3) Bills of exchange and cheques.
(4) A miscellaneous class, comprising "Bonds," "Rentes," "Funds," "Debentures," &c.

A Book-debt, or book-credit (debit and credit being merely the two sides of the same thing) is a debt which is not evidenced by a special document.

A Promissory Note is a transferable written document containing a promise to pay a sum of money. A bank-note is a promissory-note issued by a bank, payable on demand, and transferable by mere delivery. If the holder gave value for the note in good faith, the bank cannot refuse payment on the ground that the person from whom he took the note had stolen it.

A Bill of Exchange is a transferable written order to pay a sum of money. The person who gives the order is called the "drawer," the person to whom it is addressed, who usually of course is a debtor to the drawer, is called the "drawee." The latter may, on presentation of the bill to him, write his name on it. So doing is called "acceptance," and amounts to a promise by the drawee, now called the "acceptor," to pay the bill according to its tenor. A cheque is a bill of exchange drawn on a banker, payable on demand. When goods are sold on credit it is very usual for the seller to draw a bill upon the buyer for the price, payable at the time when the term of credit will expire.

5.—**Credit and Capital.**—The relation of credit to capital has been much discussed. The following passage from Ricardo is typical:—"I have no notion of credit being at all effectual in the production of commodities—commodities can be produced only by labour, machinery, and raw materials, and if these are to be employed in one place, they must necessarily be withdrawn from another. Credit is the means which is alternately transferred from one to another to make use of capital actually existing; it does not create capital, it only determines by whom that capital shall be employed."

It would seem that if, by means of Credit, the control of capital is transferred from those who make little or no use of it to those who make a better use, Credit is highly "effectual in the production of commodities," though indirectly.

We can, however, state the relations of Credit and Capital more precisely. First, a credit must be admitted to be a commodity, for it has value. A bill of exchange for £100 may be worth as much as 100 sovereigns. It also seems undeniable that it may be used as Capital. Bills of exchange assist a merchant or banker in the production of wealth at least as much as do his desks and copying-presses. The latter are regarded as capital, and therefore so must be the former.

Much confusing discussion has been caused by the neglect of the following precautions:—

(1) Distinguish "Credit" meaning a legal right, from "Credit," meaning reputation for solvency.

(2) In speaking of Credit in the former sense, remember that the matter is two-sided, and that we have not finished the examination of Credit until we have considered the corresponding Debit.

If Alpha lends £1000 to Beta, Alpha's credit is wealth. But Beta's debit is a diminution of his wealth, and is of exactly the same amount as Alpha's Credit. We may regard Debt as negative wealth.

Therefore, Ricardo is right, in a sense, in saying that Credit "does not create Capital," for by so much as Alpha's capital increases in respect of the loan transaction, by so much does Beta's wealth decrease.

Credit, meaning reputation for solvency, is of course not capital. It resembles such things as honesty, industry, &c., which are not wealth (i., 2).

6.—**Credit and Prices.**—If a seller is willing to give credit to a buyer, it may seem that prices will be affected as much as they would be by a creation of money to the extent to which the parties are willing to deal on such terms. This is not quite the case, however; the question must be investigated in detail.

Book-Credits and Prices. In the absence of any kind of credit, the general level of prices will be determined by the relation between the quantity of money in circulation and the quantity of commodities offered for sale. If quantity of commodities increases, and quantity of money remains stationary, prices must fall. Let us suppose a community where quantity of commodities offered for sale is known to increase temporarily every year between Christmas and Easter, and where it is customary to give three months' book-credits to some extent during that period only. Can prices, by this device, be kept up the year round in spite of the temporary increase in volume of commodities? Certainly during the busy season prices need not fall, for sellers are willing to give credit, and buyers, therefore, are not pinched by the necessity of finding money with which to make their purchases. But what will happen between Easter and Midsummer? During this period there will be the ordinary cash payments to make, *plus* the book-debts contracted during the busy season and now falling due. The money required for paying off the debts will diminish the quantity available for making fresh purchases, and prices must fall in proportion to the expansion in commodities whose effect has been delayed by means of credit. It would seem, then, that untransferred book-debts may affect prices temporarily, but not in the long run. They alter the period of payment, but do not provide anything with which to make the payment.

Credit Instruments and Prices. Let us now vary the illustration given above by supposing that payments between Christmas and Easter are made by bill of exchange payable three months after date, and that during their currency such bills are freely transferred. *E.g.*, Alpha buys goods of Beta, and Beta draws on him at three months. Next day Beta buys goods of Gamma, and transfers to him, in payment, the bill on Alpha. If at the end of the three months, Alpha pays the amount of the bill to Gamma, the demand for metallic money will only be the amount of the bill, whereas *two* transactions to that amount will have been carried out. Here, then, rapidity of circulation has been increased, and prices have been kept up as effectually by a credit instrument as they could have been by an addition to the coin in circulation.

Beta might keep the bill on Alpha in his desk during the three months of its currency. In that case the bill would have no more effect on prices than a mere book-debt.

There is a third mode of employing the bill Beta may desire to turn it into coin at once. In that case, he may induce Delta to "discount" the bill for him. Delta gives him, in exchange for the bill, something less than its "face-value," the difference being called "discount." The transaction is really a loan by Delta, and the discount is interest. In this case, rapidity of circulation may be said to be diminished, inasmuch as the money-value of the purchase has to

be handed over in coin *twice*—first when Delta discounts the bill, and again when Alpha pays the bill on presentation by Delta. But Delta may put the bill into circulation, and every time it is transferred by way of payment it economises coin.

We may sum up the discussion as to the effect of Credit on Prices thus :—

(1) Credit in the sense of reputation for solvency has no direct effect on prices at all

(2) Credit in the sense of a legal right, if untransferred, may temporarily, but cannot in the long run affect prices.

(3) The transfer of a credit document as payment affects prices in the same way as the transfer of money to the same amount.

(4) The currency of credits is usually limited, because it depends on the credit (reputation for solvency) of the debtor. Their effect on prices is correspondingly limited.

Bank-notes, which are created for the purpose of being circulated, and which change hands as often as coins would do, affect prices as much as coins of equal amount would do. Bills of exchange are usually transferred very few times as a rule, and therefore have but little influence on prices. As to cheques, see xv., 10.

7.—**Functions of Credit.**—We may briefly enumerate the principal economic functions of Credit.

(.) It facilitates the transfer of capital from those who can make little or no use of it to those who can make the best use of it. Thus it

(2) Stimulates production and

(3) Lessens the number of idle persons. It

(4) Collects small amounts and

(5) So renders possible undertakings of a magnitude beyond any individual's power to attempt.

(6) It enables a cheap currency (*viz.*, credit-documents) to be substituted for a dear one (*viz.*, the precious metals).

(7) It defers payments to times convenient for making them ; and

(8) Tides over periods of misfortune.

There are dangers corresponding to these advantages : economy is obtained at some sacrifice of security. Credit—

(1) Disguises weakness. An employer sometimes carries on a losing trade with borrowed capital.

(2) It stimulates speculation. When the rate of interest falls very low, the eagerness of capitalists to obtain a return for the loan of their money often induces them to lend for purposes which hold out little reasonable hope of a return.

(3) It permits competition to be carried on at a low level of morality (vi., 8).

(4) It may create a practical monopoly (vi., 8).

QUESTIONS AND NOTES.

1. What are the principal forms of Credit in a country like ours? Show how Credit promotes the growth of wealth. (*Cert.*)

2. What is credit, and what are the chief forms of credit documents used in modern commerce? Which, if either, proposition do you consider true : (*a*) "Credit is capital," (*b*) "Credit multiplies the efficiency of capital"? (*Cert.*)

3. What are the principal forms of credit used in an advanced industrial and commercial community? How does a development of credit affect prices? (*Cert.*)

4. Give your opinion on the statement in Mill's Political Economy that "Credit (like money) acts upon prices, not only as to its amount, but also as to the number of times it changes hands." (*L.C.C., Sen.*)

The words "like money" refer to the doctrine of Rapidity of Circulation (x., 9).

CHAPTER XII.

COMPETITION.

1.—**Bargaining** is the negotiation between buyer and seller, in which the former tries to secure a low, the latter a high, price. It is also called the "higgling of the market." In the wholesale markets, business is commonly carried on by bargaining. In retail trade, at the present time, in the most advanced countries, bargaining is not usual ; its place has been taken by the system of "fixed prices." Fixed prices in retail trade save the loss of time and trouble involved in bargaining, and facilitate business. A purchaser can easily and quickly compare prices and qualities offered by different traders, and select those that best suit his requirements.

2.—**Competition** is a process between buyer and buyer, or seller and seller. It is the effort to get business by the offer of better terms than others are willing to give. Buyers compete when they try to outbid each other : sellers when they try to undersell each other. A sale by auction is a

typical example of competition among buyers. The only way to get a "lot" is to bid higher than anyone else.

Unless there is keen and effective bargaining, competition will be ineffective. Thus in retail trade, when buyers are accustomed to fixed prices, they often continue to pay much higher rates than sellers could and would take if they were pressed. The consequences are sometimes baneful. Thus F. Walker points out that in the United States, between 1860 and 1870, the proportion of "middlemen" increased enormously, by reason of a rise in prices, enabling retail dealers to "push up prices unduly, working on the ignorance of buyers. The extravagant profits thus realised had not, as is well known, the effect to invite true competition, tending to reduce prices, but merely served to allow the multiplication of shops and stands at every corner, and to support an army of middlemen."

Bargaining and Competition are processes for fixing prices. There are other modes of fixing prices, *e.g.*, Custom, Law, Monopoly. Many professional charges, such as the physician's guinea, the lawyer's six-and-eightpence, are fixed by custom or law. Monopoly may be vested in a single producer or in a group of producers who act in concert by agreement. In the latter case the Monopolist is called a Combination, a Rig, a Corner, a Trust, a Pool.

3.—**Patents.**—"Letters Patent" in a wide sense means a grant by the Crown of some right or privilege, as a title of honour, or official position.

A "Patent" generally means such a grant of the sole and exclusive right to "use, exercise, and vend" an invention within the kingdom. In ancient times the Crown asserted a prerogative right to grant a monopoly, *i.e.*, in effect a prohibition to all persons except the monopolist (or "patentee," if the grant were by letters patent), to deal in a specified article. This prerogative, however, was not unlimited, and in the reigns of Elizabeth and James I., complaints were made in Parliament of grants of monopolies which were said to be illegal by the common law. In 1624 the Statute of Monopolies declared all monopolies void, with the exception of patents for new inventions, to be granted for not more than fourteen years. An abstract principle cannot be patented; nor can a discovery, as, *e.g.*, that a known substance can produce effects previously unknown.

The essential point is that the patentee should be the first person to make the invention known in this country, and the privilege is granted as a quasi-price paid by the community for the communication to it of a new invention. The term of fourteen years may be extended under special circumstances.

A patentee will fix the price of his patented commodity high or low, on the same principles that guide other monopolists. If his patent relates to sub-marine boats he will probably fix the price high, because his sales would be no larger if it were low; if his patent relates to electric bells, he will probably fix the price almost as low as competition would force him to do, because at a low price he will effect large sales.

On the expiration of the patent, (*a*) of a high-priced article, price may rapidly fall, since other producers will be ready to take advantage of the large profits; (*b*) of a low-priced article, price need not fall, and competition may appear but slowly.

In either case, competitors may be long deterred from encroaching on the trade, if the capital required for the manufacture be very expensive and highly specialised.

4.—**A Combination** to raise prices in a market, if it is to succeed, must include nearly all the producers who can supply that market; it must be able to impose social or pecuniary penalties on any member who may undersell it, and the commodity must either be such that demand will not be much diminished by a rise in price, or the fact of combination must enable production to be carried on at a lower expense of production. The expenses of management and advertisement will often be largely decreased by combination, and thus the monopolists may reap good profits without raising prices.

Under corresponding circumstances, there may be a successful combination of buyers to force down prices. The most important example of this is the labour market. "Masters are always and everywhere in a sort of tacit, but constant and uniform, combination not to raise the wages of labour above their actual rate" (A. Smith).

On the other hand, "collective bargaining" (xxix., 1) is in effect a combination of sellers of labour.

A *Pool* is a combination for the purpose of not competing, which takes three forms:—

(1) Agreements to divide the field of business, *e.g.*, railways agree not to build into each others' agreed territories;

(2) Agreements to divide business on a stated basis;
(3) Agreements to divide earnings on a stated basis.

Such agreements are held to be in restraint of trade and therefore illegal in the United States; but the law is evaded by the formation of a *Trust*, by transferring to trustees, who are pledged to carry out the desired objects, sufficient shares in the combining concerns to enable the trustees to act with effect. Such a Trust, therefore, is usually a large combination controlling the manufacture and output of some necessary commodity, often involving a considerable rise in price.

Sugar, milk, petroleum, have been thus monopolised in the United States.

Rigging the Market, or forming a *Rig*, is the operation of speculatively buying in the hope of driving prices up and then selling at the higher prices. Or the opposite course may be followed, of making contracts for the future sale of commodities, in the hope of pushing prices down and then buying, at the lower prices, goods wherewith to fulfil the contract of sale. The latter operation is liable to be met by a *Corner*. If holders of the commodity can combine and agree to withhold their stocks, they may force the speculators to pay high prices for the goods which they have contracted to deliver.

It is a similar case when workmen combine to demand high wages for labour which is necessary to the employer in order that he may execute contracts already made.

But in other cases of wages, and in the case of commodities which are to be sold under ordinary conditions, high prices usually diminish demand so much that Rigs and Corners rarely succeed. In 1888 a syndicate was formed to rig the copper market, and obtained control of the bulk of the copper supply of the whole world. Price was advanced from £40 to £90 per ton, whereupon demand fell off to such an extent that the combination failed.

QUESTIONS AND NOTES.

1. What are patent rights, and on what grounds are they economically defensible? Tell briefly what you know of the English law as to patents. Edison and Swan's patent-rights in incandescent electric lamps have just expired. Show what you think will be the effect to the producers and the consumers. (*Cert.*)

2. Give some account of "combination" as an economic phenomenon, and consider specially its influence on the value of (*a*) commodities, (*b*) services. (*A.S. of Taxes.*)

3. What conditions are most favourable to the success of corners and trusts, and what classes of commodities are best able to be monopolised by those means? By what means can monopolies of this kind best be checked? (*B.I., Fin.*)

4. Sketch the history of the monopolies in the reigns of Elizabeth and James I. (*L.C.C., Sen.*)

5. "If a speculator has bought a million quarters of Wheat, and by withholding them from the market has raised the price ten shillings a quarter—just so much as the price has been raised by withdrawing a million quarters, will it be lowered by bringing them back; and the best he can hope is that he will lose nothing except interest and his expenses." Discuss this statement. (*L.C.C., Sen.*)

The statement is made by J. S. Mill (*Principles*, iv., 2, § 5), but seems doubtful. It is well established that a deficiency in the ordinary supply of such a commodity as wheat will raise price more than in proportion to the deficiency. It has been said that a deficiency in the supply of corn of—

1	tenth	raises	price	above	the	usual	level	by	3 tenths
2	tenths	,,	,,	,,	,,	,,	,,	,,	8 ,,
3	,,	,,	,,	,,	,,	,,	,,	,,	16 ,,
4	,,	,,	,,	,,	,,	,,	,,	,,	28 ,,
5	,,	,,	,,	,,	,,	,,	,,	,,	45 ,,

This table is usually called Gregory King's law. The figures are to be taken as merely illustrative, and not as actual. Let us suppose that the million quarters mentioned by Mill are two-tenths of the usual supply, and that the usual price is 12/6 per quarter. The withholding of the million quarters raises price to 22/6. Half the million quarters can now be sold at prices varying from 22/6 to 16/3, and the remaining half million at prices varying from 16/3 to 12/6.

If the whole supply could be engrossed by a single combination, it would pay to destroy part of the stock, since the price of the remainder would rise more rapidly than its quantity would diminish. It is an easy exercise to calculate how much of the stock would be actually put on the market by such a combination, so as to secure the greatest total profit assuming Gregory King's table to be correct.

CHAPTER XIII.

MARKETS.

1.—The market for any given commodity is the aggregate of dealers in that commodity whose bids and offers affect its price. "Originally a market was a public place in a town where provisions and other objects were exposed for sale; but the word has been generalised, so as to mean any body of persons who are in intimate business relations, and carry on extensive transactions in any commodity. A great city may contain as many markets as there are important branches of

trade, and these markets may or may not be localised. The central point of a market is the public exchange, mart or auction rooms, where the traders agree to meet and transact business. In London the Stock Market, the Corn Market, the Coal Market, the Sugar Market, and many others, are distinctly localised; in Manchester the Cotton Market, the Cotton Waste Market, and others. But this distinction of locality is not necessary. The traders may be spread over a whole town or region of country, and yet make a market, if they are, by means of fairs, meetings, published price lists, the post office, or otherwise, in close communication with each other. Thus, the common expression *Money Market* denotes no locality: it is applied to the aggregate of those bankers, capitalists, and other traders who lend or borrow money, and who constantly exchange information concerning the course of business" (JEVONS, *Theory of Political Economy* [1888], 84-5).

The following points are to be noted:—

(1) A "market," in the technical sense here adopted is not a "place."

(2) There is a separate market for each separate commodity, distinct qualities of a commodity being taken as separate commodities.

2.—**The Law of Indifference**.—Jevons lays down the maxim that "in the same open market, at any one moment, there cannot be two prices for the same kind of article," which he deduces from the consideration that "when a commodity is perfectly uniform or homogeneous in quality, any portion may be indifferently used in place of an equal portion." This he calls the Law of Indifference. The maxim must be accepted with care, as the statement merely of a *tendency*, not of a *fact*. Such a tendency obviously will exist, inasmuch as no dealer will be willing, if he can help it, to accept worse terms than any other.

But in the most perfect actual market, if several bargains are made simultaneously, there will inevitably in some cases be different prices made at the same time; otherwise there would be no competition. While if a market be so organised that only one sale takes place at any one moment, *e.g.*, if all goods are put up to auction successively, then the maxim becomes a truism.

3.—**Conditions of a Good Market.**—The following are the conditions of a good market:—

(1) Publicity as to prices, quantities sold, and names of dealers. This diminishes the risk of combination, and does no harm to honest traders.

(2) Easy ascertainment of quality of commodity. This chiefly depends on the nature of the commodity. The quality of barley cannot be satisfactorily described without samples. Securities dealt in on the Stock Exchange have their nature and history described in public documents, and every dealer may know exactly what he is buying or selling.

(3) Organisation: "without organisation a market is defenceless against fraud." All the members of the Stock Exchange are bound by Rules, whose breach may be punished by loss of membership. Retail buyers are usually quite unorganised.

(4) Considerable size: *i.e.*, large volume of dealings, and large capital at the disposal of dealers. Otherwise prices will fluctuate frequently and widely.

4.—**A Perfect Market.**—In a perfect market there should be:—

(1) No combination, but an indefinite number of separate interests competing on each side.

(2) Only one price at the same time.

(3) A "close" price. This implies that the market is constituted by middlemen, *i.e.*, dealers who merely buy and sell. The selling prices of these dealers must of course be higher than their buying price at the same time, and the difference between the two (called the "turn" or the "turn of the market," on the Stock Exchange) is their gross profit on the transaction. When the "turn" is small, there is said to be a "close price" for the commodity. Consols may usually be either bought or sold with a turn of $\frac{1}{8}$: *i.e.*, the dealer makes a gross profit of 2/6 on £100 or more.

In retail markets the dealer's gross profit may average 25 p.c. On such goods as pictures, gross profit may rise above 75 p.c.

(4) Capacity to effect large transactions at short notice and with little effect on price. £200,000 of Consols may be bought or sold without affecting their price by $\frac{1}{8}$.

(5) Speed and facility in effecting transactions.

Excellence in the market will tend to keep price steady, and therefore to make production and employment continuous.

5.—**Retail Markets** are far from economically "perfect."

There is often a combination, tacit or express, among sellers to keep up prices. Buyers are seldom keen to get best value for money. Prices vary less, both from place to place and from time to time, than in wholesale trade, and are fixed more by Custom than by Bargain and Competition.

6.—**Speculation** is dealing in commodities with the purpose of making a profit out of a difference between buying and selling prices at (not the same time, as in ordinary dealing, but) different times.

A merchant buys goods of the manufacturer and sells at a higher price to retailers. He performs services to society, in keeping a stock of the commodity, and in transferring it from place to place, which enable him to make his profit. He may go on making a profit for years, while manufacturers' prices, wholesale prices, and retail prices respectively, do not vary. If, however, either of these prices should vary, there is an opportunity for making a profit in quite a different way. A dealer who foresees a rise of price will buy at present prices, keep the goods until the rise occurs, and then sell at a profit. He performs no service to society apart from the mere buying and selling. He is a speculator. But speculation is far from being useless or injurious to society, as it is sometimes supposed to be.

On the contrary, speculation performs the useful office of steadying prices and consumption. If, for example, there is an exceptionally abundant harvest in any year, price will fall, and a considerable quantity of corn will probably be wasted, so that before the succeeding crop is gathered in, there may even be a shortage, and a consequent severe rise in price. These fluctuations are lessened by speculation. The corn-dealer, as soon as he foresees an unusually abundant harvest, will hasten to sell his stocks before the fall in price occurs, which he knows is coming. This action on his part will bring about the fall earlier than it would otherwise take place. But the fall will not proceed so far as it would do in the absence of speculation. For speculators, as price goes down, will buy, against the subsequent rise, and thus check the fall. Waste, too, is thus discouraged, as corn does not become unduly cheap. And then, as the year's supply diminishes, and prices rise, the speculators put their stocks on the market, and so prevent the rise going so far as it otherwise would do.

This is legitimate speculation. But unprincipled dealers who manœuvre to produce fluctuations of prices, no doubt do harm to society at large.

7.—**Reaction of Markets.**—Markets have a reaction on Production and on Consumption. We have seen that good market organisation tends to keep prices and employment steady. There is also an educational influence. The producer may learn from the display and comparison of goods and prices to improve his methods, while, in the same way, the consumer's taste may be cultivated, and new wants developed.

QUESTIONS AND NOTES.

1. Explain the general economic meaning of the term Market, and also its particular meaning in the passages:—(*a*) "The tone of the *money market* throughout the day has been very uncertain"; (*b*) "The *cotton market* is quiet, with a demand mostly for local mills." (*Cert.*)

2. "Speculation is the struggle of intelligence against chance." Consider the economic functions of the dealer. How far do you accept the view of speculation given above? Is it possible to draw any distinction between speculative operations either in regard to their economic utility or their moral aspect? (*B.I., Fin.*)

3. Explain the essential functions of a good market, and the tests of the efficient discharge of those functions. Define a "Close Price." Enumerate the circumstances which characterise "Investment," "Speculative," and "Marketable" securities respectively. (*B.I., Prel.*)

Investment Securities are such as are suitable for yielding an income. They should be safe, and their price should be subject to as little fluctuation as possible. The return will necessarily be moderate.

Speculative Securities are such as are suitable for yielding a profit on speculative dealings in them. They should be dealt in frequently and to large amounts, and their price should vary rapidly and considerably.

Marketable Securities are such as can be readily bought and sold. There must be a large stock, held by a great number of persons, yielding a regular return, and not subject to very wide fluctuations.

4. Consider the economic effects of the action of Dealers, with especial reference to the attacks which have recently been made upon time bargains and dealings for future delivery generally.

What do you consider to be the real evils, if any, incident to dealing on the wholesale markets? Briefly indicate the kind of market policy most likely to minimise them. (*B.I., Fin.*)

A "dealing for future delivery" is a sale *now*, delivery of the article sold being postponed. Such sales can be effected on most of the great produce markets, and widen the bounds of speculation, by permitting a person who thinks that price is about to fall, to sell for future delivery at present prices, thus enabling him, if he is right in his forecast, and price falls before the agreed time for delivery arrives, to buy in order to execute his contract, at a lower price than that at which he has already sold the same goods.

"Time bargains" are dealings in Stocks and Shares for future delivery.

CHAPTER XIV.

CURRENCY.

1.—**"Money" and "Currency."**—In the chapter on "Money" we have considered the nature of money generally. We now approach the study of concrete systems of money. F. Walker discards the term "currency," on the ground that its meaning is better expressed by "money" simply. There may, however, be some convenience in maintaining a distinction between "money," that which performs a certain function, and "currency," money as organised and regulated.

2.—**Systems of Currency.**—The following are the principal systems of metallic currency which have been in operation at various times and places.

Currency by Weight. Apart from legal regulation, metallic money would need to be weighed and tested, more or less accurately, every time it changed hands. The invention of coining dispenses with this necessity, and permits metallic money to pass by "tale" (mere counting, without weighing).

Unrestricted Currency by Tale. If people use coins of various metals, whose relative values are not fixed by law, we may call this a system of unrestricted currency by tale. For instance, in England, just before the great re-coinage of 1696, there were in circulation, in addition to English coins (some of which dated from Plantagenet times), French pistoles, German dollars, Spanish pieces of eight, Dutch florins, moidores, ducats, and others.

The relative values of these coins, or of gold and silver, were not determined by law, but were left to market estimate.

Single Legal Tender. Only one metal is "standard money." This was the case in England from the time of Egbert to that of Edward III., and again from 1664 to 1717.

Multiple Legal Tender. Two or more metals are coined, and debtors allowed to pay in either metal at their option, at a ratio fixed by law. This is the principle of bi-metallism, and was in force in England from 1257 to 1664, and again from 1717 to 1816.

Composite Legal Tender. Coins of one metal are legal tender to an unlimited extent (*i.e.*, are the "standard money"), and subsidiary coins of other metals are legal tender to limited amounts.

Such is the present English system of metallic money.

3.—**Monetary Unit.**—Since it is by money that we are to measure the value of all other commodities, it is of the first importance to define the unit of money with precision. Instead of "monetary unit," Jevons speaks of "unit of value," but the expression is misleading, as he admits, "as implying the existence of something of fixed value." All that we can do is to take "a fixed quantity of some concrete substance, defined by reference to the units of weight or space," and refer variations in the relative value of such substance and any other commodity, to the latter. We can have absolute standards of weight and space, because weight and space are attributes which depend on laws of nature which for our purposes may be regarded as unvarying, and therefore the variations of our standards of weight and space (*e.g.*, at varying altitudes and temperatures) may be calculated.

We have not yet attained to an absolute standard of value, because value is an attribute whose variations depend on human conduct, and such conduct is not at present exactly calculable.

A "caprice" of fashion, a change in tastes or habits, an "accidental" discovery or invention, may profoundly affect values.

We do not necessarily assume that the value of money does not alter. But if we say that it has altered, this can only mean that we are referring money to some other standard.

The English monetary unit is the "pound sterling." This was originally a pound weight of silver; it now means 123·27447 grains of gold $\frac{11}{12}$ fine, *i.e.*, an alloy of 11 parts of gold, to 1 of alloy (silver and copper).

4.—**Coining.**—"Coins are ingots (masses of metal) of which the weight and fineness are certified by the integrity of designs impressed upon the surfaces of the metal." Coining is said to have been invented about 900 B.C. When there is confidence in the weight and fineness (*i.e.*, proportion of pure metal to alloy) as certified by the stamp, coins pass by tale. When coining is not employed, or there is no such confidence, metallic money can only pass by weight.

Coins have at different times and places been made of many different metals and alloys.

In England, at the present time, there are three classes of coins in use: gold, containing 11 parts fine to 1 of alloy; silver, containing 925 parts fine to 75 of alloy, the "ancient right standard" from time immemorial; and bronze.

The objects to be aimed at in coining are :—

(1) To prevent counterfeiting ;

(2) To prevent fraudulent removal of metal from the coin. Milling the edge was introduced for this purpose in 1696 ;

(3) To keep the loss of metal by legitimate wear and tear as low as possible ;

(4) To make the coin an artistic and historical monument.

5.—**The English Mint.**—The English coinage is issued by a government department called the Mint, which employs the Bank of England as its agent in dealing with the public. Any one can sell to the Bank of England gold bullion (uncoined metal) of standard quality at £3 17s. 9d. per oz. The Mint buys this of the Bank at £3 17s. 10½d. per oz. The difference of 1½d. per oz. is called "demurrage," because it is regarded as a payment for the advantage of turning the bullion into coin at once, instead of waiting the time which would be occupied in coining it, if the actual bullion were returned in the form of coin.

£3 17s. 10½d., then, is the *Mint Price of Gold*, and as the coinage of gold at the English Mint is not only "free" (*i.e.*, the Mint will coin any desired quantity), but also "gratuitous" (*i.e.*, no charge is made for minting), this means that an ounce of gold of standard quality is coined into three sovereigns and a fraction of a fourth represented by $\frac{17s.\ 10\frac{1}{2}d.}{20s.}$.

The same thing is expressed by saying that a sovereign weighs 123·27447 grains of standard gold. The Mint, therefore, returns to the Bank the same weight of sovereigns that it receives of standard gold to be coined.

6.—**Seigniorage.**—The Mint might make a charge for its work. It might either coin bullion to any extent desired by the public, but return, in the form of coin, a less weight of metal than it received ; or it might purchase bullion on its own initiative, coin it, and issue the coins on the principles on which token coins are issued at present. In the latter case, the coins could only be kept in circulation at a money-value in excess of their bullion-value by a voluntary restriction of the quantity issued. In the former case, there would be an automatic regulation of quantity of coins issued and their money-value, since no one would submit to the loss of metal involved in having bullion coined unless he could exchange the coins for as much as the heavier uncoined bullion delivered to the Mint.

7.—**Legal Tender** consists of those forms of money which the law of the land compels creditors, in the absence of special agreement, to accept in discharge of their claims. In England, gold is the "standard," *i.e.*, it is the material of the monetary unit, and is legal tender to any amount, provided that it weighs, the sovereign at least 122·5 grains, and the half-sovereign at least 61·125 grains. At the Bank of England and the Government offices all gold tendered is weighed, and a charge made for any deficiency.

The coinage of gold being free and gratuitous, the value of gold coins cannot vary from that of gold bullion. The case is different with silver and bronze. They are merely small change, and their metal-value is avowedly less than their money-value (less than ½ in the case of silver, and about ¼ in that of bronze). The demand for them is checked by the fact that they are legal tender only in limited amounts, *viz.*, £2 silver, 1/- bronze. Bankers supply silver and bronze to their customers in such quantities as may be desired, and themselves obtain the coin from the Bank of England as agent for the Mint, which makes a profit on the issue of these "token" coins, as they are called. On the other hand, the bankers pay surplus silver into the Bank of England, where worn coins are picked out and returned to the Mint to be withdrawn from circulation. The cost of this withdrawal is more than covered by the profit on new issues. The Bank of England charges other banks 5/- per £100 for managing their silver, including paying carriage, examining coins, throwing out bad ones, and sending worn ones to the Mint.

In addition to gold, silver, and bronze, "legal tender" includes bank-notes with certain limitations. Bank of England notes are legal tender in England (not in Scotland or Ireland) so long as the Bank gives gold in exchange for them on demand ; but they are not legal tender on the part of the Bank itself.

Notes are also issued by some other banks, and are not strictly legal tender, but if objection to them on that ground is not taken at the time they are tendered, it cannot be taken subsequently.

8.—**"Gresham's Law"** is the maxim laid down by

Sir Thomas Gresham in the reign of Queen Elizabeth, that bad money drives good money out of circulation, while good money cannot drive out bad. If a man wishes to melt or export sovereigns, he will naturally choose the newest and heaviest that he can find. Ordinary wear and tear reduces a sovereign from its full weight of 123·27447 grains to its legal minimum of 122·5 grains in from 15 to 20 years. Half-sovereigns present a larger surface in proportion to their weight, and become "light" in a shorter period.

Where there is no seigniorage on coining, as in England, a large proportion of the new gold coins will at once disappear from circulation. Gold employed in the arts will largely be obtained in this way, since the Mint guarantees a stated quality without making the charge which a private refiner and assayer would have to impose for so doing. Worn coins, on the other hand, will go on circulating until they are either refused for lightness, or withdrawn by the Government.

When, therefore, a currency has got into a very bad state, it cannot be improved by the mere issue of new, good coins. The latter simply disappear.

It must be observed, however, that Gresham's Law assumes that it pays to withdraw the good money from circulation. Ricardo pointed out that it is a "mistaken theory to suppose that guineas of 5 dwts. 8 grs., cannot circulate with guineas of 5 dwt. or less. As they might be in such limited quantities that both the one and the other might actually pass in currency for a value equal to 5 dwt. 10 grs., there would be no temptation to withdraw either from circulation." This, of course, implies that the issue of guineas is limited. By restricting the issue, their money-value may be raised above their metal-value to any extent, and Gresham's Law will not apply.

It will be seen that "picking and culling" or "garbling" the coinage, the operation described above of removing the heavy coins from circulation, will be discouraged by the imposition of a seigniorage equal to the cost of minting, since a loss equal to the seigniorage will in that case be incurred by melting or exporting even the heaviest coins. If it be desired to impose a higher seigniorage, the Mint will have to carefully regulate its issues, for in that case the money-value of coins will be regulated, not by the value of gold, but by the Mint itself, in the same way as in the case of an inconvertible

paper currency. Indeed an inconvertible bank-note may be regarded as a coin on which a seigniorage of 100 p.c. has been charged.

In favour of a seigniorage, then, it may be said that it checks excessive work at the Mint caused by the melting or exportation of new coins; against it, that trade, generally, and especially foreign trade, is favoured by a currency, whose value is not dependent on its particular shape or on the quantity issued, and is, therefore, as useful for foreign as for home trade.

9.—**History of English Currency.**—In the Anglo-Saxon system of currency the monetary unit was the Saxon pound of standard silver, which was far too large a mass of metal to be coined.

The only coins issued in considerable quantities by the Anglo-Saxon Kings were silver pennies and a few half-pennies. The usual money of account was the shilling of four or five pence. William I. fixed the shilling at its present rate of twelve pence, but a penny in those times contained $\frac{1}{240}$th of a lb. of silver, weighing, therefore, a "pennyweight." No coin called a shilling was issued before the reign of Henry VII. Up to the reign of Edward III. the small quantity of gold coins which circulated in this country exchanged for silver according to the varying market value of the gold as bullion, and silver was the sole standard of value. In that reign gold was for the first time coined in considerable quantities, and was ordered to pass current at a fixed ratio with silver. There was then a double standard; debts could be paid in gold or silver at the option of the debtor. From time to time the Mint was confronted by a certain difficulty. The coins in circulation had become reduced below their original weight, partly by legitimate wear and tear, partly by illegal clipping; and their quantity was insufficient for the trade of the country. It was well known that if the Mint, under these circumstances, were to issue new full-weight coins, they would immediately disappear from circulation, being either hoarded, melted, or exported. Not until Gresham explained this disappearance, for Elizabeth's guidance, was it understood that the reason of it was the continuance in circulation of the old light coins, and that the true solution of the difficulty was to withdraw all such light coins when issuing the new heavy coins.

Another way out of the difficulty, which was occasionally

adopted, was to issue new coins, of the same denomination as the old, but of lighter weight than the latter were when originally issued. Thus the currency was gradually "debased," so that the pound of silver was coined into more than 60 shillings, instead of 20, as it would have been at William I.'s rates. Under Henry VIII. the quality of the silver was also debased, by adding more than 75 parts of alloy to 925 of pure silver. When these debasements of silver took place, either the gold coins were correspondingly reduced, or it was declared that they should pass for a larger number than previously of the silver coins. Under Elizabeth the currency was restored to its original standard of purity, at great expense, and that standard and the weights of silver coins then adopted, were maintained until 1816, when gold became the exclusive standard of value.

The double standard, with occasional alterations of the ratio by royal proclamation, subsisted from 1257 to 1663. In the latter year, guineas were first coined. Their name was derived from the country whence came the gold contained in them, and they were intended to pass for 20/-, but no proclamation was made to that effect, and their value varied in terms of silver, which again became the sole standard. Towards the end of the 17th century the silver currency had depreciated in consequence of the large additions to the supply of silver from the rich mines of Potosi, discovered in 1550, and also had become much debased by wear and clipping, so that, in 1696, the guinea was worth 30/-, and trade was seriously inconvenienced. A re-coinage of the silver was therefore effected, and lasted from 1696 to 1699. The cost was £3,000,000, an expense as burdensome to the country then as £100,000,000 would be now, and was met by a house and window tax. When the new coins were issued the old ones were called in, and ceased to be legal tender. Thus the success of the re-coinage was not marred by the operation of Gresham's Law.

In 1717 Sir Isaac Newton, then Master of the Mint, recommended that the value of the guinea should be fixed at 21 -. This was done, and thus a double standard was once more set up. But at that rate people preferred silver, which was therefore withdrawn from circulation, leaving practically a single standard of gold, together with a token currency of those of the silver coins which were too light to be profitably withdrawn from circulation.

In 1774 silver was reduced from its legal position of joint standard with gold, by the restriction of the amount for which it was legal tender to £25.

In 1694 the Bank of England was established, and during the 18th century its notes formed a considerable part of the currency. In 1797 the country was engaged in war, and the consequent necessity of making payments abroad in gold was draining away all the available metal. To meet this contingency the Bank of England was forbidden by the Bank Restriction Act to pay coin for its notes, and the notes were in effect made legal tender, thus becoming inconvertible. In 1809 the price of gold bullion rose to £4 12s. 0d. per oz. Let us consider what that meant. Before the Bank Restriction an oz. of gold could be coined into £3 17s. 10½d., and therefore, the market price of gold could not as a rule be higher than £3 17s. 10½d. per oz.; and this whether the gold were bought with guineas or bank-notes (the notes being convertible into gold at their full nominal value on demand).

But when the notes were made inconvertible, then, in order to get 1 oz. of gold, it was necessary to give no longer £3 17s. 10½d. in notes (no guineas were to be had), but £4 12s. 0d. In other words, the notes were depreciated. And this was the conclusion come to by the Bullion Committee, appointed by the House of Commons in 1810 to inquire into the high price of bullion. In 1814 the market price of gold rose to £5 5s. 0d. per oz. In 1819 "Peel's Bill" directed the Bank of England to resume cash payments in 1823, but this was actually accomplished in 1821.

The smallest note issued was, up to 1759, for £20; from 1759 to 1793. for £10; from 1793 to 1797, for £5. From 1797 to 1829, £1 and £2 notes were issued, chiefly to facilitate the Bank Restriction and permit gold to be sent abroad. About 1826 £1 notes were forged in large numbers, and 160 persons were hanged for the offence in one year. The notes were at that time badly engraved. At the present time no note for less than £5 may be issued in England, though £1 notes circulate largely in Scotland and Ireland.

In 1816 the "sovereign" was first issued, and, at the same time, silver was made a token currency. From the time of Elizabeth the lb. of silver had been coined into 62 shillings; now it was coined into 66.

At the present time the English currency comprises legal tender (gold standard money, silver and bronze token money, bank notes), and credit documents, the latter affecting the value of legal tender in so far as they economise its use.

10.—**Debasement and Depreciation.**—"Debasement" is the reduction by the issuer of money of its weight or quality. If I lend 20/- when shillings are 20 to the pound weight, and ask for repayment when shillings are 60 to the pound weight, the law compels me to receive in full repayment 20 "shillings," but clearly I lose $\frac{2}{3}$-lb of silver in consequence of the "debasement" of the coinage.

"Depreciation" is a fall in value, however caused, "appreciation" similarly meaning a rise.

Depreciation of money, therefore, is the same thing as a rise, and appreciation is the same thing as a fall, in general prices.

Debasement will always tend to cause depreciation.

11.—**Paper Money.**—Paper money is either Convertible or Inconvertible. It is Convertible when the holder is entitled to return it to the issuer and demand gold or silver to the same nominal amount. It is Inconvertible when no such right exists. It would seem, therefore, that Convertible Paper is usually a form of credit, whereas Inconvertible Paper is not.

The value of Convertible Paper varies like that of the metal which it represents, and affects that value by economising the use of metal. Such economy has the same effect on prices as an increase in the supply of metal.

The value of Inconvertible Paper is dependent on the will of the issuer.

12.—**Convertible Paper.**—In England, Inconvertible Paper has never been employed except during the period of the Bank Restriction. Convertible Paper is permitted to be issued by the following persons:—

(1) The Bank of England, which has a monopoly in London;

(2) At distances from 3 to 65 miles from London, banks which have fewer than ten partners, and were established and issuing notes before 1844;

(3) Beyond 65 miles from London, any bank which was established and issuing notes before 1844.

The amounts of such paper that may be issued are limited as follows:—

(1) The Bank of England may issue £17,775,000 on setting aside "securities" to that value to ensure convertibility; and any further amount on setting aside gold of equivalent amount. On the latter portion of the issue there is, of course, an actual loss to the Bank.

(2) Other banks of issue incur heavy penalties if they issue more than the amount of their average issue in 1844, but they are permitted to make such arrangements as they please for securing the convertibility of their notes.

There are corresponding regulations in Scotland and Ireland. The total issue by private banks thus authorised was in 1899 about £3 millions in England, £2½ millions in Scotland, and £6¼ millions in Ireland.

13.—**Inconvertible Paper.**—Inconvertible paper money is seen (x., 2) to be a typical, ideal money. Its advantages are:—

(1) The cost of production is very small.

(2) The cost of maintenance is much less than that of a metallic currency.

This advantage might be obtained by storing all the gold now in circulation, and issuing notes to the same nominal amount.

The Government, however, would in that case be strongly tempted to use the gold in times of pressure, and thus destroy the arrangement.

(3) The value of the monetary unit is absolutely controllable by the government, and would, therefore, be susceptible of being kept more uniform than in the case of a metallic currency.

The disadvantages of such a currency arise out of the third of the above-mentioned advantages. The temptation to over-issue is enormous, for the government creates the money at an insignificant cost, and by depreciating the currency it benefits in its character of debtor.

Further, such a currency, dependent for its value on the action of a particular government, is useless for international trade.

Great as is the temptation to over-issue an inconvertible paper currency, it is not always irresistible. From 1871 to 1877, France, too much impoverished by the payment of the

German war indemnity to have a gold currency, used inconvertible paper, and yet avoided depreciation. The issue was regulated by the market price of bullion. Money was issued freely until there was observed a tendency in the price of bullion to rise above "mint-price," *i.e.*, the price at which it would have stood had a gold currency been in use. Issues were then contracted until the tendency to rise disappeared.

This method of testing the depreciation of inconvertible paper by the price of bullion, and checking it by restriction of the issue, was advocated by Ricardo during the period of the Bank Restriction.

14.—**The "Assignats."**—One of the best known instances of an issue of inconvertible paper is that of the "assignats." These were notes issued by the French Revolutionary Government in 1789, which bore interest and were nominally payable at sight, but were in fact inconvertible. Their value was "secured" by certain estates which the government had confiscated. It was argued that they could not depreciate, since they were not issued in excess of the value of the estates on which they were secured.

Thus, to put the argument in accordance with our statement (x., 8), commodities being increased by the value of the estate, and money being increased by exactly the same amount, the value of money would not be affected. But the argument was fallacious. As we have seen, the value of money depends on the ratio between the amount of it which is in circulation and the quantity of commodities which are *offered for sale day by day*. The proportion of the land of a country which is offered for sale on an average day is very small indeed, and the assignats were therefore in excess from the first, and at once effected a rise in prices. This rise enhanced, *inter alia*, the price of the estates which formed the security for the issue, and justified (on the principle adopted) a further issue of assignats on the same basis. Prices rose still higher, and the process might have been carried on to any extent. It was in fact carried so far that, in 1796, "a paper note professing to be worth £4 sterling passed current for less than 3d. in money." Meanwhile the whole trade of the country had been disorganised: "What the bigotry of Louis XIV., and the shiftlessness of Louis XV., could not do in nearly a century, was accomplished by this tampering with

the currency in a few months . . . . vast numbers of workmen, in all parts of the country, were thrown out of employment. . . . In the spring of 1791 no one knew whether a piece of paper money representing 100 francs would, a month later, have a purchasing power of 100 francs, or 90 francs, or 80, or 60. . . . says the most brilliant apologist for French Revolutionary statesmanship, 'Commerce was dead, betting took its place.'" (F. WALKER. *Money*, 341-2).

At last, in 1796, the forced currency of the assignats was abolished; every man was permitted to transact business in the money and on the terms he chose, and in a short time a metallic currency was permanently restored.

QUESTIONS AND NOTES.

1. State carefully the various functions of money, and the qualities a commodity must possess to fit it to serve as money. Define a pound sterling. (*Cert.*)

2. What is money, and what qualities must a commodity possess to render it suitable for use as money? Explain Gresham's law that "good money cannot drive out bad." (*Cert.*)

3. What is "inconvertible paper money"? Show by examples the limitations and dangers of its use. (*Cert.*)

4. Distinguish between the simple, multiple, and composite legal tender systems. (*L.C.C.* (*Banking & Currency*), *Sen.*)

5. Define the terms:—Legal tender, Token Money, Free Mintage, Mint Price of Gold. (*B.I., Prel.*)

6. Distinguish between the economic effects of a tax on the production of gold, a heavy seigniorage on gold coins, and a tax upon the import of gold. (*A.S. of Taxes.*)

7. During what years did the Bank Restriction Act of 1797 remain in force—what was its effect on the currency?
(*L.C.C.* (*Banking & Currency*), *Sen.*)

8. What was the relation of gold to silver as legal tender in England from 1717 till the adoption of the gold standard in 1816?
(*L.C.C.* (*Banking & Currency*), *Sen.*)

9. How could you (*a*) measure, (*b*) regulate, the value of an inconvertible paper currency? What are the real objections to this kind of currency? (*A.S. of Taxes.*)

10. What are the objections to inconvertible paper money? "Gold is at a premium of 180 p.c. in a certain country"; what does this mean, and to what is it due? Under what circumstances is inconvertible paper commonly used? Give historic examples. (*B.I., Prel.*)

11. Describe the various functions of money. How far are they preferably or usually discharged by the same medium? Sketch an ideal monetary system, *or* point out the merits and defects of some existing system. (*B.I., Prel.*)

12. Explain the economic principles involved in the maintenance of the following monetary pars, pointing out how far the cases are in any respect analogous:—

(*a*) Between the £1 and the shilling since 1816.
(*b*) Between the £1 and the franc during French bi-metallism.
(*c*) Between the £1 and the rupee under the Indian Currency Act of 1893. (*B.I., Fin.*)

(*a*) Shilling is a token coin, its value maintained by limitation of issue and of extent to which it is legal tender.
(*b*) See xxvii., 1.
(*c*) By the Indian Currency Act of 1893 the coinage of rupees was suspended. The object was to raise the value of the rupee by restricting the supply.

CHAPTER XV.

BANKING.

1.—**Functions.**—A Banker is a dealer in Money and Credit. We may thus classify the various operations of the business of banking:—

(1) Exchanging one kind of currency for another;
  (*a*) Bullion and coin;
  (*b*) Different kinds of coin;
  (*c*) Coin and credit: discounting a bill (xi., 6) is buying credit with cash; obtaining payment of the bill is turning credit into cash again; issuing a note is a creation of credit.

(2) Lending money, including the granting of overdrafts and cash-credits,

(3) Borrowing money, including the keeping of deposit and current accounts.

(4) Transmitting money from place to place.

(5) Acting as agent for various purposes connected with the above functions, *e.g.*, keeping valuables in safe custody, collecting money and making payments on account of customers.

These functions can be best understood by noticing their history.

Exchange of Money. In the Middle Ages, when the machinery of exchange was rude and undeveloped, merchants travelled with their goods from country to country, often carrying with them a considerable part of the money necessary for doing business. Foreign coins were thus brought into extensive circulation, and traders had to be acquainted with the relative values of many different systems of currency. To add to the difficulty, most of these heterogeneous coins were

debased, either by the issuers or by subsequent wrong-doers. Various remedies for the inconvenience of such a state of things were applied.

(1) Money-changing was carried on as a business by private persons;

(2) Royal officers were appointed, *e.g.*, in the reign of Edward I., at Dover, to exchange moneys for merchants and pilgrims coming and going between England and the Continent. The "Exchanges" in London and elsewhere were for the same purpose. Hence "Old Change" in the City of London.

(3) Banks were established, *e.g.*, the banks of Genoa (1407), Hamburgh, Nuremburg, and Amsterdam (1609).

"Before 1609 the great quantity of clipt and worn foreign coin, which the extensive trade of Amsterdam brought from all parts of Europe, reduced the value of its currency about 9 p.c. below that of good money fresh from the mint. Such money no sooner appeared than it was melted down or carried away, as it always is in such circumstances ["Gresham's Law"] . . . . . A bank was established in 1609 under the guarantee of the city. This bank received both foreign coin, and the light and worn coin of the country at its real intrinsic value [*i.e.*, its metal value] in the good standard money of the country, deducting only so much as was necessary for defraying the expense of coinage, and the other necessary expenses of management. For the value which remained, after this small deduction was made, it gave a credit in its books. This credit was called bank money, which, as it represented money exactly according to the standard of the mint, was always of the same real value, and intrinsically worth more than current money." The gold and silver deposited with the bank were retained by it, and payments were commonly made by transfers of the credit on the bank or "bank-money" (*W. of N.*, iv., 3). This bank-money was superior to the metal which it represented in the following respects:—

(1) It was secure from robbery and accidents;

(2) It could be paid away by a simple transfer without the trouble of counting or the risk of carriage;

(3) By law, all bills of exchange drawn payable in Amsterdam were obliged to be paid in bank-money.

These advantages caused the bank-money to bear an "agio"

or premium, representing its superiority in value to the precious metal deposited.

Adam Smith, writing in 1776, calculated that there might be as much as £3,000,000 deposited in the Bank of Amsterdam. In 1672 the alarm caused by the French invasion of Holland induced a run on the bank, which then appeared to have in its coffers the full nominal amount of treasure. But in 1795, on a similar occasion, the Bank was declared to be insolvent, in consequence of having lent out a large part of the precious metal which it was supposed to have kept in safe custody.

Lending. The earliest class of money-lenders in England were Jews. They carried on their trade, which was regarded at that time with great popular disfavour, from the 11th century to the end of the 13th, when they were expelled from the country. The business was also carried on by the Lombards or "Lumbers," a generic name for subjects of the republics of Genoa, Lucca, Venice, and Florence, who seem to have come here in the first instance as merchants, and agents for the collection and transmission of papal taxation, and some of whom, among other transactions, lent large sums to Edward III. They have given a name to the local centre of English banking—"Lombard Street"—and a sign to the trade of lending on pledge—the three golden balls.

The Bank of Venice was founded in 1171 for the purpose of making a loan to the government of that State. An association of merchants for such a purpose was called a "bank" or "mont" (hence "*mont de piété*" means a pawnbroking establishment). The Bank of England had a similar origin.

Up to 1546, lending at interest was contrary to English law. In that year it was permitted, with a maximum rate of 10 p.c., which in 1624 was reduced to 8, in 1651 to 6, in 1714 to 5. In 1854 all legal restriction on interest was abolished.

Borrowing. Modern English banking took its rise about 1645 out of the events of the Civil War. London merchants had found it necessary for the purposes of their business to keep considerable quantities of money in their tills. A custom grew up of depositing some part of such money in the Mint, in the Tower of London, for safe keeping. In 1638 Charles I. appropriated £200,000 of this as a "loan." The money was subsequently repaid, but the Mint lost its reputation for safety, and the merchants were thrown back on keeping their money in their own custody. Even there the money ceased to be safe on the outbreak of war, for London apprentices, in some cases, could not resist the temptation to rob their masters and seek immunity in the ranks of the armies. The goldsmiths being the best furnished with strong-rooms, other tradesmen began to secure their money by depositing it with them, from whom they took receipts called "goldsmiths' notes." By these notes, the goldsmiths undertook to restore, not the very coins deposited, but money to an equivalent amount. On the other hand, the notes were transferable, and passing from hand to hand, may be regarded as the earliest bank-notes.

The goldsmiths, finding that a substantial proportion of their deposits remained with them over and above current withdrawals, took to lending out a portion, keeping by them only so much as experience showed to be sufficient to meet probable demands. In 1672, a sum of £1,328,526 had been lent in this way by the goldsmiths to Charles II., and repayment was refused (the "Closing of the Exchequer"). In 1699, the government agreed to pay interest on that money (from 1705), but the principal has never been repaid, and at the present day forms part of the National Debt (xxv., 16).

There still exist a few London private banks, which date from the Civil War, and began business as goldsmiths or pawnbrokers.

The *Transmission of Money* belongs to the subject of the Foreign Exchanges (xviii., 5).

2.—**Local Banks.**—We now proceed to describe in some detail how modern banking is carried on.

Almost every employer in England now has an account with a bank near his place of business.

The simplest mode of making use of a bank is to have a *Deposit Account.* Alpha pays either cash or credit into the Omega Bank, on deposit. His account is credited with interest, at an agreed rate, every year, on the total amount of his deposit, and he can draw out the whole, or a part, of his deposit on demand or after giving an agreed notice.

But if Alpha is in business, he can have a *Current or Drawing Account*, and use the bank practically as a till. He can pay in money and credit every day, as he himself receives payments in business, and make all his own payments except

'petty cash" by means of cheques drawn on his account. The management of such an account gives the banker much more trouble than does a deposit account, and therefore he either allows a lower rate of interest, or none at all, or may even require to be paid for his trouble, either by a sum of money, or by Alpha keeping a certain balance at the bank on which no interest is paid. By special arrangement, Alpha may be permitted to *Overdraw* his account; *i.e.*, the bank will honour his cheques to an agreed amount, though he has nothing to the credit of his account. This is, of course, a loan to Alpha by the bank, and interest is charged on it. The best form of overdraft is the *Cash Credit*, chiefly used in Scotland. Alpha gets two substantial friends to become 'sureties" for him to the Bank up to an agreed sum. He is then allowed to overdraw his account to the agreed amount, when and as he chooses, and to pay back in such sums and at such times as suit him, interest being charged against him on the actual amount which is in advance to him from time to time.

3.—**Bankers' Profit.**—It will be seen that a bank both borrows and lends. It is a borrower in respect of its customers' deposits, a lender in respect of its discounts for customers, and customers' overdrafts. On the former it allows no interest or a low interest, on the latter it charges a higher interest.

The difference between these rates of interest is the source of the bank's profit. For the banker lends, not only his own money, but also, and to a much larger amount, he lends out the money that is itself lent to him. He finds by experience that he is called upon to meet only a certain proportion of his liabilities each day. As to part of such liabilities, he is entitled to notice. He will therefore be secure if he keeps so much "till-money" for current requirements, and in addition invests the bulk of deposits with him in such a way as to be readily available for realisation. Investments which cannot be promptly realised are unsuitable for a banker. In banking, the liabilities are large, and the time within which they may be enforced is so short that "an instant capacity to meet engagements is the cardinal excellence."

The first condition to be considered by a banker in investing or lending his surplus funds is, of course, Security. The next is Ready Convertibility, which attaches in a high degree to the discounting of commercial bills, or advances by way of overdraft, usually for not longer than three months. These advances being made for short periods, are constantly falling due, and if necessity should arise for the banker to call in funds, he need only refuse to make further advances of this kind for the time, and his available funds immediately begin steadily to increase (xxii., 2).

The third consideration with the banker is the profit that he can make. Consols are readily convertible into cash ("You can sell Consols on a Sunday"), but their price fluctuates, and in times of pressure, when the need for selling is likely to rise, will probably be low.

The banker will, therefore, often find it safer to lend money at less than 1 p.c. per annum than to invest in Consols.

A banker's business is based on the improbability that on any given day, more than a certain proportion of deposits will be withdrawn. There is no bank in England that could meet all its liabilities if suddenly required to do so. Should the depositors in any bank contract doubts of its solvency, and in consequence seek to withdraw an unusually large proportion of their deposits, the state of things called a "*Run on the Bank*" ensues. A bank is not solvent unless it is in a position to meet its liabilities as they fall due. It may therefore be broken by a "run," either because its assets are really less than its liabilities, or because, although fully able if allowed time to pay 20s. in the £, its resources are locked up, and cannot be realised in time to meet its liabilities promptly.

4.—**Structure of the English Banking System.**—The English banking system is highly organised. It has a "pyramidal" form. At the base are the "depositors," the great public who "keep a banker." Supported on these are the local banks, including in that term branch banks and bill-discounters. Bill-discounting is done by ordinary "banks" through the agency of "bill-brokers" (xviii., 5), who borrow the necessary money from "bankers' banks" at "call," paying a low rate of interest and charging a higher rate to their customers. These bill-dealers are not in England usually called bankers, because they do not receive money on deposit, but they fall within our definition of the word, since they are dealers in money and credit, and on the Continent "banker" *means* bill-broker. Above the local banks rise the "bankers' banks," while the apex of the system is the Bank of England.

5.—**Bankers' Banks.**—Every local bank is connected with one or other of a certain number of large London banks. Either the local bank has an account with such bank, or it is a branch of a bank which has such an account. The London bank treats the local bank's deposit just as the local bank treats its customers' deposits. And just as the private customer considers that his balance on current account is as available as cash itself, so the local bank regards its account with the London bank. The latter keeps a certain amount of "till-money," and has an account at the Bank of England corresponding to the local bank's account with the London bank.

In consequence of this organisation the English system is a *One-Reserve System.* The Bank of England is the only institution in this country that has any reserve of gold. The trader depends for gold, when he wants it, on his banker; the local banker depends for gold, when wanted, on his London banker; the latter depends on the Bank of England. Whenever gold is wanted in large quantities for export, it has to be supplied from the Bank of England; and similarly, when gold is imported in large quantities, it always goes to the Bank of England. The Bank therefore occupies a unique position, and although the legal fiction is that its Banking Department is carried on on ordinary banking principles, the Directors are morally bound to guide their conduct by considerations with which other bankers have no concern.

The proportion of ultimate gold reserve to liability throughout the whole banking organisation is perhaps 1 to 20. The local bank will keep one-third of its liabilities as a reserve in the form of a deposit with a London banker; the latter will keep one-third of his liabilities as a reserve in the form of a deposit with the Bank of England; and the latter will keep about half of its liabilities as a reserve in the form of bank-notes corresponding to an equivalent deposit of gold in the Issue Department.

6.—**The Bank of England.**—In the year 1694 a sum of £1,200,000 was subscribed as a loan to the Government, and the subscribers were incorporated as the Bank of England with certain powers and privileges. The Government was to pay 8 p.c. on the loan, plus £4000 per annum for management, a total of £100,000 per annum. Since that time the capital of the Bank has been largely increased, and its rights have been frequently modified.

Its present constitution is based chiefly on the Bank Act of 1844, whose principal object was to regulate the issue and secure the convertibility of bank-notes. Opinion was divided as to the proper principle on which the note-issue should be regulated, whether on the Currency Principle or on the Banking Principle. The *Currency Principle,* in accordance with which the Bank Act was ultimately framed, was thus described by its advocate, Lord Overstone: "The one great duty which the manager of the currency has to perform, is that of making the amount of the paper circulation vary precisely as the amount of the circulation would have varied had it been exclusively metallic." The opposing *Banking Principle* is that the currency cannot be unduly inflated by note-issue so long as such notes are in fact promptly convertible into metal.

Had the latter principle been adopted, all reasonable facilities would have been given to banks to issue notes, the only object of any restraint being to secure that issues were not so far extended as to, in fact, endanger the convertibility of the note. The opposite policy having been chosen, the Act embodied it in the following provisions:—

(1) The Note-issue Department of the Bank of England is to be kept distinct from the Banking Department, and the latter is to be conducted on ordinary banking principles.

(2) A Return showing the Bank's position is to be published every week.

(3) The Issue Department is to be permitted to issue 14 millions unsecured by deposit of gold, and any further amount provided an equivalent quantity of gold is deposited in the Department.

(4) No issues are to be made by any other bank, with the exception that banks which at the date of the Act were entitled to issue notes may continue to do so, not exceeding their average issues at that date. If any such bank for any reason should discontinue to issue notes, it is not to be permitted to resume issue, but the Bank of England may be authorised to increase its fiduciary issue by two-thirds of the amount of the lapsed circulation. The fraction $\frac{2}{3}$ was chosen because it was considered that issuing banks usually retained gold to the amount of one-third of their note issue, in order to secure the convertibility of such issue. In virtue of this provision the fiduciary circulation of the Bank has been increased from time to time, and now stands at £17,775,000.

At the present time the Bank of England is distinguished from other banks by the following peculiar features :—

(1) It is the Bank of the Government, collecting Government Revenue, managing the National Debt, and making and receiving all payments on behalf of the Government.

(2) It is the principal bank of issue.

(3) It has to publish accounts weekly.

(4) It acts as agent of the Mint.

(5) It does not remit money, nor allow interest on deposits. It has a few branches.

7.—**Objections to the Bank Act.**—The following objections have been made to the policy of the Bank Act :—

(1) The fiduciary circulation is too small. The limit chosen was adopted because the notes in circulation had never been observed to fall below 22 millions. The issues of other banks were about 8 millions, and 14 millions were allowed to the Bank of England. But since the Act, notes in circulation have never fallen below 32 millions. The total authorised fiduciary circulation is less now than it was in 1844, although the gold in circulation has increased. In 1844 there were about 36 millions of gold in circulation in the United Kingdom, and the total note circulation was about 37 millions. In 1883 the figures were 110 millions gold, 42 millions notes.

(2) The object of the Act was to put a stop to the occurrence of "crises" by controlling the note issue. But there have been crises in spite of the Act, and in those of 1847, 1857, and 1866, the Act was suspended ; *i.e.*, permission was given by the Government to the Bank of England to issue notes in excess of its legal limit.

(3) It would be better to have a standing rule, permitting the note-issue to be automatically increased in times of pressure, than to be dependent on the uncertain action of the Government in suspending the Act. It is well to give no encouragement to speculation in times of over-confidence, but when credit contracts, and there is a great demand for money for the purpose, not of launching out into speculation, but merely of meeting liabilities already incurred, persons whose business has been properly conducted should be able to get accommodation at a high price. The note-issue might be made elastic, and permitted to expand by 3 or 4 millions when discount rises to 8 p.c., by 3 or 4 millions more when discount rises to 10 p.c., and so on, the profit on

such issues going to the Government. There is such a provision in Germany.

With regard to the Bank of England generally, our system has the following defects :—

(1) The gold-reserve is smaller than it should be. The consequence is that there occur frequent and violent changes in the discount rate.

(2) The whole monetary system of the country is dependent on the action of a single board of directors.

(3) The interests of the bank shareholders are opposed to those of the public.

8.—**A Weekly Return.**—The following was the Return published by the Bank of England for the week ending 25th July, 1900 :—

ISSUE DEPARTMENT.

Notes Issued	£47,664,140	Government Debt	£11,015,100
		Other Securities	6,759,900
		Gold Coin and Bullion	29,889,140
	£47,664,140		£47,664,140

BANKING DEPARTMENT.

Proprietors' Capital	£14,553,000	Government Securities	£20,418,545
Rest	3,534,586	Other Securities	28,154,842
Public Deposits	9,766,559	Notes	17,545,900
Other Deposits	39,862,417	Gold and Silver Coin	1,750,436
Seven-day and other Bills	153,161		
	£67,869,723		£67,869,723

The issue of notes is based on "partial deposit." Of the total issued, nearly 30 millons were secured by a deposit of gold in the vaults. The balance, £17,775,000 is a "fiduciary" issue ; *i.e.*, it is secured, not by precious metal, but by claims against the Government and other persons to that amount. Of the notes issued, 17½ millions were in the Banking Department, leaving 30 millions in the hands of the public.

The Bank was a debtor—

(1) To its shareholders to the amount of their capital, 14½ millions, and to a further amount of 3½ millions ("Rest") in respect of undivided profits;

(2) To the Government, in respect of deposits amounting to nearly 10 millions,

(3) To other persons, in respect of deposits amounting to nearly 40 millions.

To meet these liabilities the Bank had—

(1) Its "Reserve" of coin and notes, amounting to nearly 20 millions,

(2) Claims against the Government and other persons, valued at 48½ millions.

9.—**The Clearing House.**—The controversies which have occurred in respect of the Bank Act and the note-issue have lost much of their importance in consequence of the growth of banking and the habit of making payments by cheque. In order to complete our survey of banking organisation, we have to consider the machinery by which cheques are dealt with, and its influence on prices. If the recipient of a cheque at once presents it at the drawer's bank and demands cash, rapidity of circulation is not increased. But, as a rule, the receiver of a cheque has a banking account of his own, into which he pays the cheque as a deposit. Thus, each bank every day receives as deposits, cheques drawn on other banks. So that, taking any two banks, say Union and National, Union becomes National's creditor by the amount of cheques on National paid into Union by its customers, and debtor by the amount of cheques on Union paid into National by *its* customers. If all the cross-claims thus arising can be set-off against each other, to that extent transactions can be carried on without the use of cash, with a corresponding increase in rapidity of circulation. Such a "cancellation of mutual indebtedness" is effected by means of Clearing Houses. In London and other large towns, the chief banks send clerks every day to a room where they effect the set-off. The set-off of course is seldom exact: there are balances over. Total cheques on Union paid into other banks may be 10 millions; total cheques on other banks paid into Union may be 9½ millions, leaving a balance of half a million to be paid by Union.

Even this balance is adjusted without cash, by entries (in London) in the books of the Bank of England.

The London Clearing House was established in 1775. There were 46 clearing bankers in 1810; the number is now smaller. Every non-clearing-banker has a clearing-banker as agent.

In 1899 the London clearing amounted to £9000 millions.

10.—**Advantages of Banking.**—A good banking system enables the functions of Credit to be performed on a large scale.

(1) The control of wealth is transferred from those who are unable or unwilling to employ it productively to those who have both power and will so to do.

(2) Goods which are produced for exchange should be exchanged as quickly as possible, and credit facilitates such exchange.

(3) Credit is not only a means of transferring the control of capital; it also substitutes a cheap for an expensive currency. In this sense credit creates capital, in so far, that is, as money is itself capital, part of the machinery of production (vi., 5).

Bankers have been called "solvency-meters." It is their business to know whom to trust, and it is through their agency that capital is withdrawn from trades that are less to those that are more productive. Thus risk is reduced, and therefore rate of interest falls.

English trade is largely carried on with borrowed capital. Comte recommended that economic society should be managed by three bankers—one understanding trade, the second manufactures, the third agriculture.

As to Scotland, in particular, it has been said that banking is to its trade what the Nile is to the agriculture of Egypt.

QUESTIONS AND NOTES.

1. Define Credit, and describe the different forms it takes in an advanced industrial nation, such as England. How does a good Banking System promote the trade of a country? (*Cert.*)

2. What gives value to a Bank of England note and to an ordinary cheque drawn by a private person on his banker? How do banks employ the money of their depositors? (*Cert.*)

In taking the Bank of England note, one looks rather to the solvency of the Bank than to that of the payer, whereas in taking a cheque,

one looks rather to the solvency of the drawer than to that of the banker on whom it is drawn.

3. Explain the terms Convertible and Inconvertible as applied to paper currency, and trace out the different effects of a large issue of either. How is the convertibility of Bank of England notes secured? (*Cert.*)

A large issue of Inconvertible paper currency will depreciate the currency (*i.e.*, produce a rise in prices), see xiv., 10; x., 7.

A large issue of Convertible paper may tend to raise prices. This will tend to cause an adverse exchange and a rise of discount (Ch. xviii.), which will tend to bring back the notes as deposits. Especially if gold has to be sent abroad, the notes will come in and gold will be demanded in exchange, for export.

4. Describe in general terms the mode in which a banker conducts his business, and the way in which his profits are made. (*Cert.*)

5. How does a bank make its profit? What is meant by a run upon a bank? In what cases may a run upon a bank cause its failure? (*Cert.*)

6. Sketch briefly the leading provisions of the Bank Charter Act. (*L.C.C., Sen.*)

7. Distinguish between Assets, Reserves, Hoards, and Till Money.

"The notes in the banking department of the Bank make not only a part, but a most important and active part of the currency of the country." (McCulloch.)

Explain the above statement. how far is it applicable to the state of affairs during the last year or so? (*B.I., Fin.*)

The notes in the banking department are called "active" because they represent the gold in the Issue Department, and this is the ultimate reserve in reliance on which transactions to some twenty times its value are being constantly carried on.

8. In what way does the Bank of England act as the sole banking reserve of the country? What figures in its weekly returns represent this reserve? (*L.C.C., Sen.*)

9. Describe, with historical illustrations, the chief functions of banking. How far are these functions discharged by the Bank of England, and to what peculiar dangers is the English banking system liable? (*A.S. of Taxes.*)

CHAPTER XVI.

THE MONEY MARKET.

1.—In every developed market, money is one term of every exchange, and therefore in a sense, every such market is a money-market. But the expression "Money Market" is used with a meaning which is cognate with that given to the phrase "the value of money," as meaning hire-price, not sale-price (x., 7). On the Money Market, dealers are not buyers and sellers, unless we speak of selling cash for credit

and *vice-versa* (xv., 1). It is more intelligible to say that they are lenders and borrowers. The price paid for a loan is called either Interest or Discount.

2.—**Interest and Discount.**—Interest is sometimes distinguished from Discount by saying that it is the price paid for the loan of Capital, whereas Discount is the price paid for the loan of legal tender.

Another way of distinguishing them is to call the former the rate for long, the latter the rate for short, loans.

The discussion of Interest belongs rather to the department of Distribution than to that of Exchange, and therefore we are here concerned chiefly with Discount. In order to see how the rate of Discount is affected we have to observe that—

(1) The total quantity of commodities in existence at any moment is very much greater than the quantity which is being offered for sale.

(2) Prices are adjusted to the proportion between the total money available for exchanges and the quantity of goods offered for sale day by day.

(3) Much of this "money" consists of credit documents.

It follows that if there should be a sudden increase in the quantity of commodities offered for sale, or if there should be a sudden shrinkage of credit (*i.e.*, less willingness to give credit), there may be great temporary difficulty in obtaining money wherewith to carry on exchanges at current prices. Opposite movements will have opposite results, *i.e.*, will cause a "glut" of money. In the former case, the "price of money," *i.e.*, rate of discount, will rise; in the latter case it will fall.

There is a direct connection between rate of Discount and rate of Interest. Most of the large banks allow interest on deposits at a rate which varies with the Bank rate of discount, being generally 1½ p.c. lower than that rate. And further, since advances at interest are always made in the form of money, the scarcity of the latter and consequent high rate of discount will put difficulties in the way of making the advance, and therefore raise its price.

3.—**Lenders and Borrowers.**—On the London Money Market the borrowers are chiefly "bill-brokers" (xv., 4) and Stock Exchange dealers.

The bill-brokers employ the money in discounting trade-

bills which represent business in miscellaneous commodities done on credit. The Stock Exchange dealers employ the money in more or less speculative transactions in stocks and shares, which tend to secure uniformity in the yield of the various forms of loan and investment, allowance made for varying risks.

The lenders are bankers, who have large sums of money in their hands, for which they pay no interest, or very little, and which they will therefore be willing to lend at the highest rate they can get, however low it may be, rather than keep them unemployed.

4.—**"Market" and "Bank" Rate.** The current rate of discount is fixed partly by the play of demand and supply—supply consisting of the funds offered by banks, demand consisting of the sums which bill and Stock Exchange dealers desire to employ.

Thus is fixed the "Market" rate, the rate at which lenders, other than the Bank of England, are willing to do business. But the Bank of England, in deciding what rate to charge, has to take account of circumstances with which other dealers have no direct concern. It is the largest lender in the market, some part of whose supply is always necessary to satisfy demand, and its rate, the "Bank Rate," leads and controls the market rate, though it rarely coincides with it exactly. The Bank Rate is the published rate, which is changed from time to time, but less frequently than the Market Rate, which is constantly varying, at which the Bank of England is willing to discount first-rate bills, *i.e.*, bills issued by persons of undoubted solvency. In order to understand the principles on which the Bank Rate is fixed, we must revert to the organisation of banking and the peculiar position of the Bank of England.

5.—**The Reserve and the Discount Rate.**—We have seen (xv., 5) that the whole banking system of the country is dependent on the "Reserve" of the Bank of England. When the exchanges are unfavourable (Ch. xviii.) there is a tendency for gold to leave the country, and, therefore, for the Reserve to diminish. But if this reserve were permitted to quite disappear, there would be universal bankruptcy. The Bank could neither discharge its own liabilities, nor could it enable other persons to discharge theirs.

Practically the whole of the traders in the country rely ultimately on the Bank of England for the means of meeting demands on them. Whenever, therefore, the Bank perceives that its Reserve is likely to be reduced to a point which is regarded as unsafe, it has to take steps to check the reduction. This is effected by raising the Bank Rate. The consequences of the rise are numerous and important.

(1) The market rate also rises, though it may be in a lesser degree.

(2) Bill-brokers and stock-jobbers are less willing to borrow; hence

(*a*) Bill-brokers are less willing to buy and more willing to sell bills on foreign countries; foreigners are less willing to demand payment of debts due to them, and more willing to give extended credit at the raised rates, and may even send money here for investment; and therefore the exchanges become more favourable.

(*b*) Merchants, having to pay higher rates for getting trade-bills discounted, are less willing to do business, and therefore there is a tendency for general prices to fall.

(*c*) Stock-jobbers are less willing to buy and more willing to sell stock; and therefore stock-exchange prices tend to fall.

(3) The interest paid by bankers rises (xvi., 2), and therefore the public are more willing to leave money on deposit. Buying of goods is thus discouraged, and general prices tend to fall.

(4) The fall of general prices tends to discourage importation and to encourage exportation. The consequence will be a more favourable exchange, but it takes some time for the exchanges to be affected by this cause, whereas they are immediately affected in the modes above mentioned.

We may sum up by saying that a rise in the Bank Rate tends to lower general prices, to raise interest, to make the exchanges more favourable, and to cause an influx of gold, which, finding its way to the Bank, will check that decrease in the Reserve which induced the raising of the Rate.

The opposite effects follow an increase in the Reserve and a fall in the Rate.

6.—**Public Funds or Rentes.**—When a government "issues a loan," the subscribers in effect give money in exchange for the government's promise to pay an annuity of

fixed amount, with or without an additional promise to repay the sum advanced (or some other sum) at a date which may or may not be stated. The amount of the annuity is usually defined as a percentage. Thus, a loan at 3 p.c. means that for every £100 advanced, £3 per an. will be paid. A loan may be issued at par, at a premium, or at a discount. If at par, £100 is paid for the annuity plus a right to repayment of £100; if at a premium, more than £100 has to be paid, and if at a discount, less for the same rights. After the loan has been issued, subscribers can transfer their rights to other persons, at prices determined by bargaining and competition.

The bulk of the English National Debt is now in the form of Stock called "Goschens" (because it was issued by Mr. Goschen in 1888-9 to replace the stock then existing). The annuity is $2\frac{3}{4}$ p.c. until April 5, 1903, and $2\frac{1}{2}$ p.c. thereafter. The government has agreed not to pay off the stock before April 5, 1923, but may redeem it at par thereafter, as parliament may determine. On September 8, 1899, Goschens were quoted $104\frac{1}{2}$—$104\frac{5}{8}$, *i.e.*, dealers were willing to sell the ultimate right to £100 and the intermediate annuity, for £104 12s. 6d., or to buy the same for £104 10s. 0d. On January 8, 1900, the price was $98\frac{9}{16}$—$98\frac{11}{16}$. This difference is connected with the fact that at the former date the Bank Rate was $3\frac{1}{2}$ p.c., while at the latter it was 6 p.c., and bankers were paying 4 p.c. on customers' deposits, whereas at the former date they were paying no more than 2 p.c. In January, 1900, therefore, it was worth while to sell Goschens and lend the price to bankers, and the competition of sellers brought down the price.

The price of government funds is therefore closely connected with the rate of interest, and the gain derived from transactions in them is more like profit than interest, since its amount is not fixed by contract. Whoever bought Goschens in September, 1899, and sold them in January, 1900, lost money on the speculation.

It is customary to assume that the current rate of interest, on perfectly safe securities, is indicated by the price of Consols ("Goschens"). If these are at par, then the current rate is $2\frac{3}{4}$ p.c., and any difference between that rate and any other which may be in fact paid at the time is equivalent to insurance against risk. If the price of Consols is above or below par, then the current rate of interest is proportionately below, or above, $2\frac{3}{4}$.

The price of Funds will therefore depend partly on the current rate of interest, and partly on the estimated security of the particular investment. Thus the loans of such states as Turkey, Greece, and the South American republics, stand at much lower prices than those of England and France. They yield a greater return, but investors take a greater risk.

QUESTIONS AND NOTES.

1. Primitive trade was barter; then money was devised; highly organised trade tends to revert to barter. Explain this evolution, referring to (*a*) the services rendered by money, and (*b*) the means by which economies are effected in its use. (*B.I. Prel.*)

(Cp. Ch. xi.) "Highly organised trade tends to revert to barter" is a very loose statement. It only means that in highly organised trade little or no metallic money changes hands. But such trade is differentiated from barter by the following circumstances:—(1) Values are measured by money; (2) Prices are dependent on quantity of money, if not directly, through the banking reserves.

2. Explain, as fully as you can, as if to the first class of a school, the following quotations from a newspaper:—(*a*) "Bank rate, 4 per cent. New Consols ($2\frac{3}{4}$) were $110\frac{3}{8}$." (*b*) "Foreign stocks show very irregular movements." (*Cert.*)

3. Explain the term Value of Money. What do you understand by money being cheap? On what does the value of public Rentes chiefly depend? (*Cert.*)

4. What are the principal causes of the rise and fall of the bank rate? (*L.C.C., Sen.*)

5. Distinguish carefully between interest, profit, and discount. How are they related, and by what are they respectively determined? Describe the causes which affect the Bank Rate, and account for the importance attached to its movements. (*B.I., Fin.*)

6. Account for the importance which is attached to the movements of the Bank rate of discount. How do its variations affect (*a*) mercantile profits, (*b*) the price of securities, (*c*) the foreign exchanges? (*A.S. of Taxes.*)

7. What are the usual causes of a low rate of discount? The low rates that have prevailed during the last few years are sometimes held to be a proof that the fall of prices cannot be due to an appreciation of gold. Define the term Appreciation of Gold, and examine the argument. (*B.I., Prel.*)

8. Describe roughly the way in which Consols are held, and the part played by them and by similar securities in modern finance.

Consider the causes, and some of the chief effects, of the present low rate of interest obtainable on first-class securities; and discuss the probability of any rise in this rate. (*B.I., Fin.*)

CHAPTER XVII.

FLUCTUATIONS OF PRICES.

1.—The tacit assumption usually made that the value of money remains constant from time to time (in other words, that money is an unvarying standard of value, or for deferred payments) is frequently erroneous. Changes in the value of money, or, in other words, in the general level of prices, do occur, and have the most far-reaching effects on the history of nations, classes, and individuals.

A continued fall in prices has both political and industrial effects. Politically, it adds to the power and wealth of those who are already powerful and wealthy, since it increases the purchasing power of fixed sums of money, whether capital or income. Industrially, it checks business activity, by reducing profits and rendering them precarious. It is difficult, too, to reduce money-wages in proportion to the fall in prices of material commodities. Real wages thus rise; a benefit dearly bought at the expense of a contraction of the field of employment.

A continued rise of prices has opposite effects. Politically, it lightens the burden of taxation, injuring the "moneyed" classes and benefiting the active members of the community. Industrially, all who are entitled to fixed sums of money, whether as capital or income, are losers, while profits increase, the employing class are stimulated, real wages fall, but business expands, and rapidly compensates labourers by way of an increased field of employment with rising money-wages.

Either a rise or a fall of prices works mischief, by inflicting undeserved losses and giving undeserved gains. But whereas the fall exerts a numbing and deadening effect on human activity, a gentle rise is stimulating and invigorating on the whole. A rapid rise, however, is disastrous (xxx., 1).

2.—**Causes of Fluctuations.**—A change in general prices must be caused by either (or both), (1) a change in the quantity of goods offered for sale; or (2) a change in the quantity of money in circulation.

1) The quantity of goods offered for sale will vary in consequence of—

(*a*) Changes in the efficiency of industry, which tends to increase on the whole, and, therefore, exerts a steadily depressing effect on prices.

(*b*) Changes in the number of times the same goods are put on the market, which also tends to increase, with the same effect (x., 8).

(*c*) Changes in the proportion of goods in existence which are put on the market, which also tends to increase (x., 8; xix., 2).

When "credit" contracts, traders are driven to put an unusually large quantity of goods on the market, and to effect "forced" sales at low prices.

(2) The quantity of money in circulation will vary in consequence of—

(*a*) Variations in the yearly output of the money-metals;

(*b*) Variations in the quantity of money-metal used otherwise than as money; *e.g.*, for hoarding, or in the arts;

(*c*) Changes in the mint-regulations. *E.g.*, between 1878 and 1888 silver was demonetised in several states, and £200 millions of gold were used to take its place. Debasement of the currency sometimes occurs, and adds to the quantity of money in circulation.

(*d*) Variations in the extent to which credit-documents are used as money.

3.—**Classes of Fluctuations.**—Certain fluctuations of prices (including discount) occur at approximately regular intervals. There is a well-marked *Autumnal Pressure* in the money market, shewing itself in rising discount. This seems due to the fact that the summer and autumn are the spending season. The harvest has to be got in and sold, remittances are made for holiday expenditure, and more money is therefore wanted by the public than at other seasons. The country banks first feel the pressure, which falls on the Bank of England in October.

A *Quarterly Fluctuation* is caused by the quarterly payment of dividends on the National Debt, rent, &c. There is a slight fluctuation once a fortnight caused by the custom of settling Stock Exchange transactions at that period. Further, there are local fluctuations due to special conditions.

During the first half of the 19th century there was a well-marked *Ten Year Period* of fluctuations or Credit-Cycle. In 1793, 1811, 1825-6, 1837, 1847, 1857, and 1866 there were well-marked *Crises*. In 1878 there was a maximum of bankruptcies, but since that date the Ten-year period has not clearly shewn itself. These crises usually occurred in the

autumn. The special Ten-year Cycle, pushing down still lower than usual the regular autumnal depression, produced that acute condition of business difficulty which is called a crisis. The term implies that a relatively large number of employers find it impossible to obtain means wherewith to meet their current engagements, although they may be able ultimately to pay 20/- in the £, if time be allowed them to realise their property.

Prof. Marshall thus describes a "credit-cycle":—"The beginning of a period of rising credit is often a series of good harvests. Less having to be spent in food, there is a better demand for other commodities. Producers find that the demand for their goods is increasing: they expect to sell at a profit, and are willing to pay good prices for the prompt delivery of what they want. Employers compete with one another for labour; wages rise; and the employed in spending their wages increase the demand for all kinds of commodities .... Credit is jubilant, and readily accepts paper promises to pay. Prices, wages and profits go on rising .... Many speculators, seeing the rise, and thinking it will continue, buy goods with the expectation of selling them at a profit. At such a time a man who has only a few hundred pounds can often borrow from bankers and others the means of buying many thousand pounds' worth of goods; and every one who thus enters into the market as a buyer, adds to the upward tendency of prices, whether he buys with his own or with borrowed money.

'This movement goes on for some time, till at last an enormous amount of trading is being carried on by credit and with borrowed money. .... Trade is in a dangerous condition. Those whose business it is to lend money are among the first to read the signs of the times; and they begin to think about contracting their loans. But they cannot do this without much disturbing trade. If they had been more chary of lending at an earlier stage, they would simply have prevented some new business from being undertaken; but when it is once undertaken, it cannot be abandoned without a loss of much of the capital that has been invested in it. .... Distrust increases; those who have lent become eager to secure themselves, and refuse to renew their loans on easy or even on any terms. Some speculators have to sell goods in order to pay their debts; and by so doing they check the rise of prices. ....

A speculator who has borrowed money at interest to buy goods may be ruined if he holds them a long time, even while their price remains stationary; he is almost sure to be ruined if he holds them while their price falls. When a large speculator fails, his failure generally causes that of others who have lent their credit to him; and their failure again that of others. .... As credit by growing makes itself grow, so when distrust has taken the place of confidence, failure and panic breed panic and failure. The commercial storm leaves its path strewn with ruin. When it is over, there is a calm, but a dull, heavy calm. .... Thus the state of trade, to use the famous words of Lord Overstone, 'revolves apparently in an established cycle. First we find it in a state of quiescence—next improvement, growing confidence, prosperity, excitement, overtrading, convulsion, pressure, stagnation, distress, ending again in quiescence.'"

The absence of marked crises of late years may be due to improvement in banking. It is the banker's function to foresee the tendency to crisis, and to counteract it.

The high organisation of modern production and exchange renders trade sensitive. Production is carried on for future and distant markets, and may be deranged by unforeseen events, while transactions to a vast amount are carried on with a comparatively small amount of metallic money (x., 9).

If a crisis can be foreseen it can be checked by restricting credit in good time. When the contraction of credit has actually set in, liberal advances should be made to all whose ultimate solvency is above doubt, but at high rates. It was to enable this to be done that the Bank Act of 1844 was suspended in the crises of 1847, 1857, and 1866 (xv., 7).

4.—**Course of Prices.**—Some conception of the importance of changes in the general level of prices and their connection with the supply of money-metal may be obtained by a brief historical review.

While Rome was engaged in her career of conquest, she obtained possession from time to time of her enemies' hoards. But when the *pax Romana* put an end to this source of supply, the stock of precious metal in the Roman world began to diminish, for the Romans were not successful miners.

It is estimated that the stock was 358 millions in A.D. 14, and that it decreased to 34 millions by the year 806. The declension of the Roman Empire is with some probability

attributed to this cause. The tributes of the provinces had to be paid in fixed amounts, while the diminution in the stock was forcing prices down. The result was that the provinces had to give an increasingly greater share of their produce to Rome, and became impoverished while riotous extravagance was corrupting the capital. From 806 to 1492 there was a Silver Famine, the material cause of the stagnation of the Dark Ages. Among the causes of the Renascence, not the least effectual was the gold and silver of the New World. The western world's stock of precious metals in 1600 is put at 130 millions, in 1810 at 308, in 1830-1848 at 330 millions. The latter period was one of peace and growing trade and population. The stock of money-metal being stationary, the result was a fall of prices, which is regarded as the cause of the sufferings which produced Chartism in England and Revolutions on the Continent.

In 1848-50 new supplies of gold began to arrive from California and Australia, and the strain was relieved. From 1850 to 1870 was a period of improvement and prosperity, which may be attributed to Free Trade, railways, &c., but is certainly not unconnected with the supply of gold. During these 20 years there were added to the world's stock some 637 millions gold, 345 millions silver, of which the East took a total of 25 millions per annum, 500 millions in all.

About 1870 the production of the mines began to slacken, and between 1870 and 1880 it is computed that there were used for extraordinary purposes nearly 200 millions of gold, *viz.*, 84 millions by Germany, 16 millions by Italy, and 100 millions by the United States (xvii., 2). A fall of prices accordingly set in, which has continued almost to the present time. It seems likely, however, to be checked and perhaps converted into a rise, if the recent enormous increase in the world's annual gold output is maintained. This output about 1850 was under 30 millions, about 1880 had fallen nearly to 20 millions, but in 1899 was over 66 millions.

Prices in London were three times as high about 1600 as in 1500. Our Poor Law and the Civil War are thought both to have been caused by the rising prices: the former because wages rose slowly while commodities rose rapidly in price, the latter because the king's necessities led him to impose vexatious taxation.

Prices were high at the beginning of the 19th century, but had fallen by a half in 1850.

In 1887 general prices were lower than in 1845-50, having meanwhile risen 42 p.c.

QUESTIONS AND NOTES.

1. Explain how debasing the currency of the country affects its industries. Give illustrations from English History, and from the history of the French Revolution. (*Cert.*)

2. What is meant by the Appreciation and the Depreciation of Gold? State the reasons for the conclusion that gold has undergone a considerable appreciation in the last 10 years. (*Cert.*)

3. Give a brief account of *one* of the following:—

(*a*) The historical connection between the introduction of token currency and the disuse of the system of double legal tender.

(*b*) The course of average wholesale prices in England during the last hundred years.

(*c*) The changes in the structure and functions of the English banking system since 1844. (*B.I., Fin.*)

4. Estimate the effects (*a*) of a gradual, (*b*) of a rapid rise in the purchasing power of money. Suggest causes which may bring about either result. (*A.S. of Taxes.*)

5. Distinguish between the functions of the dealer, the capitalist, and the employer. A general fall of prices is said to benefit the capitalist at the expense of the employer. Discuss this. (*B.I., Prel.*)

6. Distinguish between the necessary and avoidable causes of fluctuation in prices and employment. (*B.I., Prel.*)

CHAPTER XVIII.

INTERNATIONAL TRADE AND FOREIGN EXCHANGES.

1.—Let us imagine two neighbouring islands, of which one, Alpha, is unfertile, but rich in minerals; the other, Beta, is poor in minerals, but fertile. Naturally Beta will be devoted to agriculture, Alpha to manufactures, and portions of their respective products will be exchanged.

2.—**Relative Advantage.**—We will suppose that the production of a ton of coal requires two days' labour in Alpha, four in Beta; that of a quarter of wheat requires three days' labour in Alpha, one in Beta; and that a wooden table can be made in either island with the same amount of labour, that of two days. We may say that Alpha has an absolute advantage over Beta in regard to coal, an absolute disadvantage as to wheat, and an absolute equality as to wooden tables. It is clear that it will be to the advantage of both

is ands to exchange Alpha's coal for Beta's wheat. But it requires reflection to perceive that it will be more economical for one of the islands to manufacture all the tables that both require, than for each to make its own. It may easily be shewn, however, that there will be a saving of labour on the whole if all the tables are made in *either* island, but that the gain will be greater if they are made in Alpha than if they are made in Beta.

(1) Let all the tables be made in Beta. If Alpha imports a table, she saves from table-making two days' labour, which will raise a ton of coal. If that ton be sent to Beta in exchange for the table, Beta gets a ton of coal, which would cost her four days' labour, in return for the product of two days' labour: a saving on the whole of two days' labour.

(2) Let all the tables be made in Alpha. When one is imported into Beta, Beta saves two days' labour from table-making and devotes it to wheat-growing, thereby producing two quarters. These two quarters, if sent to Alpha in exchange for the table, will save Alpha six days' labour, which would be there necessary to raise so much wheat: a saving on the whole of four days' labour.

The most economical arrangement, then, will be for Beta to devote herself to wheat-growing alone, leaving Alpha to produce both coals and tables. The relation between Alpha and Beta is expressed by saying that Alpha has a "relative advantage" over Beta in the manufacture of tables. For if Beta neglects wheat-growing to make tables, she neglects a trade in which she has an absolute advantage of three to one in favour of a trade where she has an absolute equality. Whereas, if Alpha neglects coal-raising in order to make tables, she neglects a trade in which she has an absolute advantage of only two to one in favour of a trade in which she has an absolute equality.

An improvement in the method of producing an exported article is the same thing as an increase in the relative advantage of the exporting country.

3.—**"Territorial Division of Labour."**—Just as exchange makes possible division of labour within a country, so international trade makes possible division of labour within the wider community formed by all the inter-trading states. This truth has been emphasised by calling International Trade the "Territorial Division of Labour."

If the student will again read through the above illustration, but instead of calling Alpha and Beta different countries, will regard them as individuals carrying on business within the same community, Alpha being a miner, and Beta an agriculturist, he will find that the conclusions reached will be unaltered by the change.

4.—**Value in International Trade.**—In order to see how such a trade as we have imagined would be actually brought about, we must assume a theory of value. An approximation to such a theory is to suppose that commodities exchange in the ratio of the labour spent in their production. This is but a rude approximation, since it neglects the conditions of Demand, and greatly simplifies those of Supply.

If there is no trade between Alpha and Beta, a table in Alpha will be worth $\frac{2}{3}$ of a quarter of wheat, and in Beta will be worth two quarters. If, now, trade be permitted, there will be a profit of 200 p.c. (neglecting cost of carriage, &c.) on buying tables in Alpha with wheat and selling them for wheat in Beta.

In order to investigate the subsequent history of the table-trade, we need to enlarge our theory of value, by taking into account the effects of relative Supply and Demand.

The export of tables from Alpha to Beta and of wheat from Beta to Alpha will, as to tables, decrease the supply in Alpha and increase it in Beta, and as to wheat, decrease the supply in Beta and increase it in Alpha. There will result a tendency, as to tables, to higher values in Alpha, lower values in Beta; as to wheat, to higher values in Beta, lower values in Alpha. Dealers' profits will be diminished by this tendency to make the wheat-price of tables the same in both islands. If this price were ultimately fixed at $\frac{2}{3}$ of a quarter, we might say that Beta gained the whole benefit of the trade; if at two quarters, that Alpha gained the whole benefit. At what point between these extreme limits the price will rest will depend on the nature of the total demand for each export. If, *e.g.*, a small reduction in the value of tables greatly increases the demand, whereas wheat may fall considerably in value without much increase in demand, then the value of tables will rise as compared with wheat, and Alpha will derive more benefit from the trade than Beta.

5.—**International Movements of Money.**—The

study of the movement from country to country of money in its various forms, including credit-documents, is called the study of the *Foreign Exchanges*.

We suppose that a merchant in Alpha, whom we will call Importer A, has bought goods worth £100 from a merchant in Beta, whom we will call Exporter B, and desires to pay for them. It will be a very convenient mode of doing this, if Importer A can obtain an order on some person in Beta, directing such person to pay £100 to Exporter B, and transmit such order to the latter. An order of this kind is a bill of exchange (xi., 4), and may be drawn by any person who is a creditor of the "drawee."

Now suppose that a merchant in Alpha, Exporter A, has sold goods worth £100, to Importer B, in Beta.

Exporter A is a creditor of Importer B for £100, and therefore entitled to draw a bill on him for that amount. This he does, and sells the bill for £100 to Importer A. This transaction satisfies the parties in Alpha. Importer A has paid £100, Exporter A has received £100. Importer A transmits the bill to Exporter B, who presents it for payment to Importer B. On payment by the latter, the parties in Beta are satisfied. Importer B has paid £100, Exporter B has received £100, and thus cross dealings between Alpha and Beta are settled without the use of metallic money.

Actual transactions of this kind are facilitated by a class of dealers called bill-brokers (xv., 4), to whom importers and exporters resort, to buy and sell bills, paying, of course, a commission for the accommodation. Bills thus become commodities, whose price is regulated by demand and supply. So long as the total payments on all accounts due from Alpha to Beta balance the total payments due from Beta to Alpha, exchange is at par; *i.e.*, a bill for £100 on Alpha or Beta can be bought in Beta or Alpha for £100, allowing for the broker's commission. But if this balance is not maintained, bills rise to a premium in one country and fall to a discount in the other.

Suppose that more money is due from Alpha to Beta than from Beta to Alpha. Then bill-brokers in Alpha will find that bills on Beta are in demand (by those who owe money in Beta) to a greater value than are being offered to them (by those who have claims on Beta). They will, therefore, ask more than £100 for £100 bill on Beta, and exchange on Beta is said to be at a premium or in favour of Beta. At the same

time bill-brokers in Beta will find that bills on Alpha are in demand (by those who owe money in Alpha) to a less value than are being offered to them (by those who have claims on Alpha). They will, therefore, be willing to sell a £100 bill on Alpha for less than £100, and exchange on Alpha is said to be at a discount or against Alpha.

The usual limit to premium and discount is the cost of transmitting money-metal.

A sovereign contains the same quantity of gold as 25 francs $22\frac{1}{2}$ centimes. Therefore, when a bill on Paris for 25·22½ fr. can be bought in London for £1, exchange on Paris is at par.

The carriage of a sovereign between London and Paris costs 10 centimes. A London merchant who owes money in Paris will rather buy a bill at the rate of £1 for 25·15 fr. than send gold; but he would rather send gold than pay for a bill at the rate of £1 for only 25·10 fr. Thus, when exchange on Paris rises above £1 for 25·12½ there is a tendency for gold to flow from England to France, and, on the other hand, when exchange on Paris falls below £1 for 25·32½ fr., there is a tendency for gold to flow from France to England.

25·22½ fr. for £1 is called the *mint par of exchange*.

25·10$\frac{7}{8}$ fr. for £1 is called the *outgoing specie-*, or *gold-* or *bullion-point*.

25·32½ fr. for £1 is called the *incoming specie-*, or *gold-* or *bullion-point*.

We have seen (xvi., 5) that the Bank of England raises its rate whenever there is a prospect of a drain of gold, and we now see how this follows an adverse exchange. On the other hand, a favourable exchange tends to an influx of gold, and permits a lowering of the Bank rate.

6.—**"Balance of Indebtedness."**—The tendency of money to enter or leave a country depends on many circumstances. The value of material imports is due abroad, the value of material exports is due at home. Large sums are occasionally due from England for investment abroad; large sums are due to England annually by way of profit and interest on foreign investments and loans; money is due abroad every year to support travellers, and absentee capitalists, landlords and employers; money is due inwards in respect of work done for foreign countries, notably for freight earned in the carrying-trade; money is due outwards to pay Government expenses abroad, in respect of wars, diplomatic service, &c.

There is an automatic tendency for the total of money due outwards to equal the total of money due inwards.

7.—**Exports balance Imports.**—Where two countries exchange two commodities it is obvious that the value of the import into either country is the same as that of the export from it. But when the foreign trade of a country is extensive and multifarious, the truth that the total value of imports must equal the total value of exports is not so obvious. It is important to get a clear view of this truth.

The course of international trade is determined by Price. When a merchant is considering whether to export or import commodities, he looks only to Prices in gold, in the various countries under his notice.

Importation is always from countries where price is comparatively low, to countries where price is comparatively high.

Let us suppose, now, that during any given period the total amount of payments due abroad from England exceeds that of payments due in England from foreign countries.

We have seen (xviii., 5) that the consequence will be an exchange adverse to England, and a tendency for gold to leave the country. If this tendency is sufficiently strong, the Bank of England will raise its rate (xvi., 5), and the consequence of this will be a fall of prices, an encouragement to importation into England, and a discouragement to exportation from it, the result of which will be a tendency towards equalisation of English claims due abroad with foreign claims due in England.

Similar reasoning will show us that if during any period the total amount of payments due abroad from England falls short of that of payments due in England from foreign countries, there will ensue a state of foreign exchanges on the whole favourable to England, a fall in discount rates and a rise in prices here, an encouragement to importation and a discouragement to exportation, tending to restore the balance.

Thus the normal state is the equation of international indebtedness, and any variation from it tends to disappear.

8.—**Surplus of English Imports.**—In 1898 there were imported into the United Kingdom material commodities (not including money-metal) to the value of over £470¼ millions, and there were exported similar goods to the value of over £294 millions. The figures for 1899 were about £485 millions imports and nearly £330 millions exports.

The discrepancy between the respective values of imports and exports involves no breach of the law that the total value of a country's exports must equal the total value of its imports, but is accounted for by the other causes of movements of money to which we have referred (xviii., 6). Large payments, *e.g.*, are due every year in England for freight earned abroad. These payments will tend to make exchange favourable to England, the English rate of discount will fall, general prices in England will rise, importation will be encouraged, exportation will be discouraged. Hence, a tendency for material imports to outvalue material exports. We may sum up in this way:—The total value of exports of all kinds (including services, money-metal, and also credit-documents of all kinds) must equal the total value of imports of all kinds. Freight, therefore, earned abroad by English shipowners, must be regarded as payment for an export of Services (an "invisible export") which may be balanced by an import of material commodities. If English capitalists make large investments abroad, an excess of material exports over imports may ensue. The investment takes the form, in the first place, of an export of Rights against English people, or, as we may say, of English Debits. The actual export is in the form of bills on England. This operation turns the exchanges against England, discount rises, prices fall, and exportation of material commodities is encouraged.

When the investment has been made, and the dividends are coming in, the opposite result is seen. The dividends are paid here by bills drawn on foreign countries, the exchanges turn in our favour, discount falls, prices rise, importation is encouraged.

The excess of English material imports over exports indicates the extent of the claims that England has against other countries apart from exportation of material commodities.

QUESTIONS AND NOTES.

1. What conclusions as to the state of British trade may be drawn from the following passage:—

"The value of our imports last month (Sept.) showed a decrease of 6 p.c. upon the corresponding total a year ago. . . . Exports on the other hand show an increase of nearly 5 p.c." ? (*Cert.*)

2. Is it true that England is being impoverised by her foreign trade, because the imports largely exceed the exports in value? Account for the excess in value of the imports. (*Cert.*)

3. Why do we consider the great excess of our imports over our exports as a satisfactory feature in our economic position? (*Cert.*)

4. Indicate concisely the chief advantages of foreign trade. On what principles is the proportion of gain accruing to each trading country determined? Apply your conclusions to the division of gain from improved methods of production for export. (*A.S. of Taxes.*)

5. British exports measured in money have fallen during the past year, while values of imports have not declined. What is the explanation? Does the fact imply any reduction of national wealth, of trade, or consumption? (*B.I., Fin.*)

6. What causes, other than those connected with the balance of exports and imports, affect the course of the Foreign Exchanges?

Explain the effect, for example, of the payment of the Franco-German indemnity upon the French, German and English exchanges. (*B.I., Fin.*)

The Franco-German indemnity was largely paid by the transfer to Germany of French claims on England. Germany required payment of these claims in gold, wherewith to establish her new gold currency (xviii., 4). There was, therefore, an exchange adverse to England, an outflow of gold, and a very high rate of discount.

7. Show that employment of English capital in foreign countries does not necessarily tend to diminish the demand for labour at home. (*Cert.*)

An English capitalist will not send his capital for investment abroad unless he can get a much higher return than he could at home. Export of capital, therefore, implies relatively low interest and abundant capital in the exporting country. The foreign investment causes an increased exportation of English goods followed by increased importation. The field of emloyment of capital is enlarged, productive efficiency is increased, and the abundance of commodities, which constitute the real reward of labour, is also increased.

DISTRIBUTION.

CHAPTER XIX.

GENERAL CONDITIONS.

1.—Under the heads of Production, Consumption, and Exchange, we have studied the functions which must be performed in order that wealth may be produced at the places and in the quantities and varieties desired by consumers, and the machinery by which such production is effected. We have found that Production involves four kinds of economic activity, which we call that of Labour, Land, Capital, and Enterprise respectively. In parts of our discussion we have spoken of the services to production rendered by Things—Land and Capital. But economics, being the study of "*human conduct* in relation to wealth," is concerned primarily, not with fields, tools, machinery, &c., but with the men who own, or borrow, or use such things. The co-operation in production of Land, Labour, Capital, and Enterprise necessarily involves the co-operation of Landowner, Labourer, Capitalist, and Employer, and it is the fact that these characters are sustained for the most part by different men, and different classes of men, in present day industrial life, that gives rise to the scientific study of economic questions.

The topic that we now have to discuss is the terms on which these four classes of men, Labourers, Landowners, Capitalists, and Employers, co-operate in Production.

The question is sometimes put thus:—How is the wealth which is produced, distributed or shared among those who have contributed to its production? If we adopt this form we must remember that those who contribute to the production of a particular commodity are not usually remunerated by a share of that commodity. An Englishman may spend his life filing brass, and obtain as the result of his labour a miscellaneous assortment of necessaries, comforts, and luxuries, never including a piece of brass that he has himself filed. But if we regard all the people of the economic world as a whole, we may then say that the activity of each contributes to the total of commodities produced, and is rewarded by a share of such total. Refer to the diagram, iii., 3.

2.—**Distribution and Exchange.**—Developed economic societies are distinguished from less advanced communities by the greater proportion of goods which are bought and sold. Among primitive peoples, there is little dealing. Even

among ourselves there is an enormous mass of services which are not bought and sold, but are consumed by the producer himself, or are rendered from motives of family affection, friendship, religion, philanthropy, &c. There is also a considerable quantity of material goods which are not bought and sold, but are consumed or given away by the producer—garden and farmyard produce, home-made clothes, "handy" contrivances, home-prepared food, &c. But the market is constantly encroaching. Christmas puddings, which a few years ago it was the universal custom to make at home, are now largely produced and sold by confectioners.

It is this prevalence of Exchange which gives rise to questions of Distribution.

When a man consumes his own produce, turned out by his own land, labour, and capital, we see clearly the connection between industry and efficiency on the one hand, and quantity and quality of goods on the other. The intervention of the market makes it a matter no longer of sight, but of inference, to trace out the corresponding relation. A man's remuneration depends on the value, not directly on the quantity or quality of his contribution to production.

Distribution is effected by a series of exchanges.

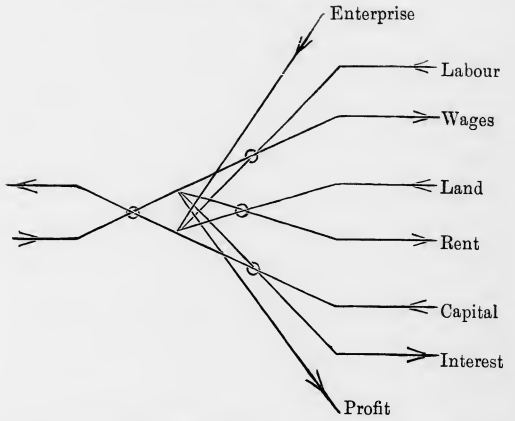
The landowner sells the use of his land, the labourer sells his services, the capitalist sells the use of his money, and the employer is remunerated by the portion of the price of the finished commodity which remains to him after paying all the other expenses of production.

Wealth may be exchanged though the price be not distributed; *e.g.*, a peasant-proprietor who sells his produce. On the other hand, wealth which is not exchanged may yet be distributed; *e.g.*, there is a division of the actual produce as between metayer landlord and tenant.

It is the organisation of industry which has made necessary both exchange and distribution—exchange because producer and consumer are different persons; distribution because different persons (having separate legal interests) unite in production.

The diagram given in iii., 3, therefore, requires to be modified as below in order to show that Wages, Rent, and Interest are Prices.

Those crossings of lines which indicate an exchange are surrounded by a circle; the other crossings of the lines do not signify anything.



3.—**Theory of Value applied to Agents of Production.**—Since we define Rent, Wages, and Interest as Prices, it would seem that they must follow the Laws of Value. But the Theory of Value, in its full form, applies to Commodities which are produced by the co-operation of Land, Labour, Capital, and Enterprise, whose production and value are mutually dependent, and which come into existence for no other purpose than to be put upon the market. In these respects, such commodities differ from the agents of production. It is true that Land, Labour, and Capital have value, and therefore are commodities, but, unlike other commodities, they do not come into existence primarily for the sake of what they will fetch by way of exchange. Their peculiarity with regard to determination of value is that they have no Expense, though they may be said to have a Cost, of Production.

There is no definite outlay that a landowner must make in order to offer 100 acres on lease, or that a capitalist must make in order to lend £100, or that a labourer must make in order to do a day's work.

However small the return may be, in either case, the producer cannot say he has made a loss on the transaction, and must therefore, curtail supply, in the same precise way in which the producer of ordinary commodities may do so.

It is the relation between expense of production and price which guides the ordinary producer in regulating the supply, and thereby value of his commodity. The result of the absence of such a guide in the case of the production of the agents of production themselves is that as to these we are unable to state exact general laws with regard to supply.

The law of Demand is the same with regard to Land, Labour, and Capital, as with regard to ordinary commodities, and the effect of Supply on value is the same. But the effect of Price on Supply is not direct and all-powerful, as it is in the case of other commodities.

4.—**"Commercial" and "Industrial" Competition.**—We have seen that the supply of commodities other than the agents of production is regulated by the relation between price and expense of production (ix., 11), which tend to equality under the influence of competition. Competition of this kind is called "commercial," and is based on an exact comparison. A brickmaker puts down in figures what his bricks cost him, he adds to that amount whatever he may consider a "fair" profit, and compares the total with the price he may expect to get for his bricks; and such comparison is his guide in deciding whether to make more or fewer bricks, or none at all.

It is a different kind of competition, called "industrial," which goes on between the agents of production as each endeavours to secure employment.

The result of such competition is thus stated by Adam Smith (*W. of N.*, i., 10): "The whole of the advantages and disadvantages of the different employments of labour and stock [capital] must, in the same neighbourhood, be either perfectly equal or continually tending to equality. If, in the same neighbourhood, there was any employment evidently either more or less advantageous than the rest, so many people would crowd into it in the one case, and so many would desert it in the other, that its advantages would soon return to the level of other employments. This at least would be the case in a society where things were left to follow their natural course, where there was perfect liberty, and

where every man was perfectly free both to choose what occupation he thought proper, and to change it as often as he thought proper. Every man's interest would prompt him to seek the advantageous, and to shun the disadvantageous employment.

"Pecuniary wages and profit, indeed, are everywhere in Europe extremely different, according to the different employments of labour and stock. But this difference arises partly from certain circumstances in the employments themselves (xxiii., 2), which either really, or at least in the imaginations of men, make up for a small pecuniary gain in some, and counterbalance a great one in others; and partly from the policy of Europe [the Mercantile System (ii., 5)], which nowhere leaves things at perfect liberty."

The same notion has been expressed by defining the Net Advantages of an employment as the sum of its advantages *minus* the sum of its disadvantages, and saying that the net advantages of all trades tend to equality.

"Industrial" competition differs from "commercial," in not being based on an exact comparison, and in the relative independence of price and supply. Only very rough estimates can be formed as to the respective Net Advantages of various occupations. Beyond certain limits, no rise of price could cause an increase in the supply of land; labourers are not brought into existence for the sake of their wages; capital is saved to a large extent without regard to the rate of interest.

5.—**Functions and Persons.**—The various functions necessary to Production may be discharged by different persons, or a single person may discharge all or some of them.

A peasant proprietor, for instance, is the owner of his land, and works on it himself with his own capital. He represents in his own person the functions of Land, Labour, Capital, and Enterprise. In this case we may analyse his total returns, and say that the equivalent of what he could let his land for represents Rent, the equivalent of what he would have to pay a man to do his work represents Wages, the equivalent of what he would have to pay for the loan of the value of his farming stock, &c., represents Interest, and whatever remains over is Profit.

6.—**Differential Gain.**—If (1) commodities produced with the same expenses of production are sold during the

same period at different prices, or if (2) commodities produced with varying expenses of production are sold during the same period at the same price; the sellers will not all make the same rate of profit, but there will be "differential gains" obtained by them. We may dispose briefly of the first case above mentioned by saying that examples of it may easily be found, but that it is of much less importance than the second, which requires careful study.

It must be remembered that we now speak of normal, not market, price. The latter may at any time be below expenses of production. But normal price being that towards which market prices constantly tend, it must of course be sufficient to remunerate the producer according to his reasonable expectation. This implies that if the commodity is produced with expenses of production varying as between different producers, the price must be an adequate remuneration to that producer whose expense of production is the highest, for otherwise such producer will curtail his production.

It follows that other producers will make "differential gains," *i.e.*, gains over and above the lowest which would induce them to produce, if they could get no more. Such gains will in the first instance, of course, be "profit." We have to inquire whether any forces will come into play, tending to divert such exceptional gains from the employer to any other class of producer, and we proceed to examine several cases, varying in respect of the seat of the cause of the exceptional profit. Such cause may be situated either in the Labour, the Land, the Capital, or the Enterprise of the favoured employer.

1) *Exceptional efficiency of Labour.* If the exceptionally efficient labour be that of the employer himself, whether of organisation and contrivance, artistic taste, or inventive or persuasive power, the differential gain thence arising must remain with him, except in so far as other gifted men, excited by his gains, compete with him and lower price by increasing supply. If the exceptionally efficient labour be that of hired assistants, the latter will be able to obtain more or less of the differential gains thence arising by way of bargaining with the employer. Competing employers may offer such assistants, in order to obtain their services, more or less of the differential gains which they hope to obtain by their help. Thus, bargaining and competition will tend to transfer the differential gain to

the exceptionally gifted labourers to whose services it is due. But here, again, an influx of competitors may be attracted, and the gain reduced.

(2) *Exceptional efficiency of Land.* The cause of differential gain may be the possession of a piece of land of peculiar fertility or richness in minerals or of advantageous position. Competing employers will be willing, in order to obtain possession of such a piece of land, to offer to the owner of the land, in the form of rent (in the ordinary sense of the word), a sum which will tend to equal the estimated value of the differential gains which may be made by means of the land. Thus the competition of employers will tend to hand over the differential gain to the landowner.

(3) *Exceptional efficiency of Capital.* The cause of differential gain may be the possession of some specialised Capital of peculiar efficiency; *e.g.*, a machine. If the machine, for any reason, cannot be duplicated, the case resembles the second above given, and the owner of the machine can absorb the differential gain. But if other machines of equal efficiency can be made, other employers will be willing to pay the amount of the differential gain in order to hire the means of obtaining such machines. Hence, in the first place, an offer of interest for the loan of money for investment in such machines. The process would be checked by the consequent increase of output and lower price. But on the whole, differential gain due to employment of capital tends to disappear and to be replaced by an increased demand for loans, and corresponding tendency to a rise in the rate of interest.

(4) *Exceptional efficiency of Enterprise.* The mere fact that an employer is established and known in the trade, enables him to produce at a lower expense of production than a new man. He can dispense with advertisements, &c., and get credit more easily and cheaply. The risk of starting a business is so much greater than that of continuing a paying concern that "goodwill" (the probability that old customers will continue to deal with the firm) enables large differential gains to be made and retained by the employer. This is in fact the main source of Profit pure and simple. Of the many who have or might obtain the means, and have the necessary knowledge and ability, few are willing to take the huge risk of starting a business. Of

those who do take the risk, some fail. Of those who survive the initial period of loss and struggle, some can make differential gains. Numbers of employers in most trades are hovering on the brink of failure. They are the less capable or fortunate, who produce at the highest expense of production, and make little or no profit.

CHAPTER XX.

RENT.

1.—By the word "rent" we shall mean simply the price actually paid for the use of "land," understanding by "land," not only the gifts of nature, but also wealth which has been produced by human industry, and so incorporated with "land" in the more strict economic sense as to follow the economic laws relating to "land," rather than those relating to "capital" (v., 1; xx., 10). "Rent," or "economic rent," is often used by economic writers in the sense of differential gain due to exceptional efficiency of land (xix., 6). Such differential gain, as we have seen, does tend, under competition, to be handed over by the farmer to the landlord; but the reader is advised to sharply distinguish between "rent," the price of the hire of land, and "differential gain," whose estimated value chiefly guides the competing farmer in making an offer for the land.

2.—**Ricardo's Theory of Rent.**—The Theory of Rent which is usually stated is, in brief, that the Rent of a piece of agricultural land *is*, or is *determined by*, the differential gain which a farmer might make by its cultivation. This Theory is usually attributed to David Ricardo, though it was put forward as early as 1777 in James Anderson's "Enquiry into the Corn Laws." Ricardo illustrates the theory thus:—"An uncultivated tract is settled by a small colony. As long as there is an excess of land of the best quality, and everyone may take possession of it without paying anything for it, no rent is possible. But if all the first-class land is under cultivation—land which perhaps with the employment of a small amount of capital yields five quarters an acre per annum; and the increasing population necessitates the cultivation of land of the second class, which with the same outlay of capital yields only four quarters an acre per annum, there arises a rent of one quarter an acre per annum for land of the first class. At the price [now obtained] four quarters [are] enough to cover the cost of production, and it must be a matter of indifference to a new comer whether he obtains five quarters from land of the first-class as a farmer and pays out one quarter, or whether he harvests four quarters from second-class land as proprietor."

Briefly, "The Economic rent of a piece of land is found by subtracting from the value of its annual produce an amount sufficient to return the farmer's outlay with profits."

In Ricardo's illustration, given above, we measure the amount which is "sufficient to return the farmer's outlay with profits," by observing the yield on the worst land under cultivation—the "second-class" land. This land, it is assumed, pays no rent, and the crop just repays all the outlay on it. The first-class land is cultivated under similar conditions, and at an equal expense, and produces a surplus of one quarter per annum, which is called rent.

3.—**"Margin of Cultivation"** (Prof. Fawcett) is the worst soil which it is necessary to bring under cultivation in order to satisfy the aggregate demand for products of the soil, at a price sufficient to cover expenses of production on such soil. In Ricardo's illustration, given above, the "second-class" land is on the margin of cultivation. As the demand for agricultural produce increases, inferior qualities of land must be successively resorted to in order to satisfy such demand. The worse the quality of land brought under cultivation, the higher will be the expense of production, and the higher, therefore, will be the price of agricultural produce, and the greater will be the differential gains made by means of the superior qualities of land. As the price of agricultural produce falls or rises, so will rise or fall the margin of cultivation.

4.—**"Dose of Capital"** (James Mill).—"Margin of cultivation" refers primarily to space—the area of land under cultivation, extending when prices rise, contracting when prices fall. But it may be used in another sense—in intensity, instead of extensity. We have seen (iii., 4) that more or less Labour and Capital may be applied to the same piece of land, and we have noted the effects of varying the quantities so

applied. Successive equal increments of Labour and Capital so applied may be called "doses," and the law of diminishing return may then be expressed by saying that the return due to each successive "dose" tends to become less.

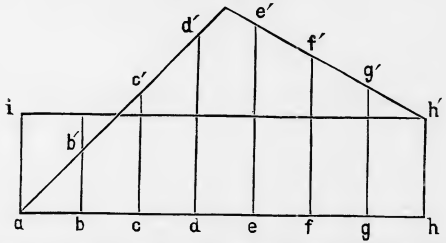
It is clear that if the price of the product rises, more doses may be profitably employed. We must here note and avoid a possible misconception. When we say that the Law of Diminishing Return is that the return due to each successive dose tends to become less, we are speaking of *quantity, not value*, of the return. It may well happen, therefore, that it will pay a farmer to apply more doses of capital and labour, though he do so under conditions of *diminishing* return. True, he gets a smaller *quantity* of produce as a return to the later than he does as a return to the earlier doses, but inasmuch as prices have risen, he is recouped for his outlay.

The last dose of capital which it pays to employ may be said to be on the "margin" of employment.

The following statement of the law of Rent may now be intelligible:—"If a farmer applies as much capital to his land as he profitably can, his rent is what remains after deducting from his total produce the return to his last dose multiplied by the number of doses he applies."

The comprehension of this theory will be facilitated by the following simple diagram:—

5.—Diagrammatic Representation of Theory of Rent.



Let *ab*, *bc*, *cd*, &c., represent successive doses of capital and abour, and let *ab′b* represent the return to *ab*, *b b′c′c* the return to *bc*, &c.; and let the parallelogram *gh′* represent the

return which is just sufficient to remunerate the farmer for one dose. Then *gh* will be the last dose, for the return to another would not repay it. The figure *iahh′* represents the output necessary to compensate the total outlay, the figure *ab′c′d′e′f′g′h′h* represents the actual output, and the excess of the latter over the former represents "differential gain," which competition tends to transform into Rent.

6.—**"No-rent Land."**—The following statement of the law of rent requires careful consideration. "The rent of a piece of land is the excess of its produce over the produce of an adjacent piece of land which is cultivated with an equal amount of capital, and which would not be cultivated at all if rent were demanded for it." The last mentioned land is on the margin of cultivation.

The qualification "an adjacent piece of land" is necessary, because advantage of position (*e.g.*, proximity to market or to canals, railways, &c.) has the same effect on rent as greater fertility.

If by "rent," "differential gain" is intended, we can at once assent to the above statement, and also to the following: "We may lay it down as a principle that so long as any of the land of a country which is fit for cultivation, and not withheld from it by legal or other fictitious obstacles, is not cultivated, the worst land in actual cultivation (in point of fertility and situation together) pays no rent."

But we cannot assent to either statement if it is intended that landowners ever let land rent-free, which the language of many text-books would seem to imply.

We can no more assume that a landowner will allow his land to be employed productively for nothing, than we can assume that a man will lend his capital, or do work, or undertake the risks of trade, for nothing. We can find instances of all these things: land let at no rent, capital lent at no interest, work done at no wages, business carried on at no profit.

But in every such case, either—

(1) The motive is non-economic, such as charity; or

(2) The result is unforeseen and undesired, as in the case of business failure or trade disturbance; or

(3) The condition is regarded as a means either to other remunerative employment or to avoid a positive loss.

So that wherever we find services rendered to production without remuneration, we must either regard them as dis-

turbances to economic theory, because proceeding from non-economic motives, or else we must regard them as "market" fluctuations, not "normal" conditions.

7.—**"Rent does not enter into the price of agricultural produce."**—We are now in a position to examine this proposition, which is usually given as a deduction from the Ricardian rent theory.

The argument is as follows :—

(1) All produce is sold at the same price.

(2) The price must remunerate the labour, capital and enterprise bestowed on the worst land in cultivation.

(3) The worst land in cultivation pays no rent;

(4) Therefore, if no rent at all were paid on any land, prices would be no lower than they in fact are.

Here, again, we can accept the statement, if by "rent" we may understand "differential gain," but not if by rent we are to understand "the remuneration received by the land-owning class for the use of the native and indestructible powers of the soil" (F. Walker). Writers on economics do not clearly distinguish between these two things, and sometimes seem to confuse themselves as well as their readers, in consequence of using the word "rent" in two different meanings. The truth underlying the proposition in question is this—that high prices of agricultural produce are the cause, and not the consequence, of high rents of agricultural land.

8.—**Rise and fall of Rents.**—It may appear paradoxical, but is a fact, that improvements in the art of agriculture, or in milling, or in the means of transport, may have the effect of reducing rents. In the beginning of the 18th century the counties in the neighbourhood of London petitioned Parliament against the extension of turnpike roads, which, they said, was causing a decline in rents.

Similarly, agricultural rents have declined in England generally, and lands have gone out of cultivation, during the latter part of the 19th century, in consequence of improvements in the means of bringing agricultural produce from foreign countries.

We shall have no difficulty in understanding these results if we remember that the chief ingredient in Rent is Differential Gain (xix., 6), and that Differential Gains increase with the fall, and decrease with the rise, of the Margin of Cultivation (xx., 3).

The improvements mentioned above tend to raise the margin of cultivation, that is, to permit the whole supply to be raised on lands of high fertility, and under conditions of maximum efficiency. Thus lands of low fertility are not cultivated, and the law of Diminishing Returns does not exert a great influence, and the difference between the yield of the best land under cultivation and that of the worst, which measures Differential Gain, is not large. Improvements in transport reduce the advantages of situation, which we have seen have the same effect on Rent as greater fertility.

The advance of civilisation tends to raise rents in the following ways :—

(1) Growth of population increases the demand for land and its products, and so tends to lower the margin of cultivation.

(2) Growth of wealth tends to promote the use of better and more abundant food and all other products.

(3) Growth of cities and manufactures tends to utilise land for other purposes than the production of raw materials and food.

9.—**Rent of Mines, &c.**—The peculiar feature in these cases is that the property which is hired out is of a "wasting" character. The rent is usually calculated on a double basis—

(1) An agreed rent called "dead rent," determined on much the same principle as agricultural rent; together with

(2) A "royalty," *i.e.*, an agreed sum per ton, &c., of ore, &c., gained.

10.—**House-rent.**—It is sometimes said that in the rent of houses we may distinguish two elements :—

(1) "Rent," due to site;

(2) "Interest," due to the capital expended in building.

But when capital has once been "sunk" in land, whether by building, or in any other way, the return to it obeys the law of Rent rather than that of Interest. The capital has become "specialised" (vi., 3) and the law of Interest applies to non-specialised capital. *E.g.*, the money spent in drainage works has given a return of 25 to 70 p.c. per annum in England and Belgium (Roscher, *Principles*, ii., 36 n.). This is very different from what is regarded as the rate of interest in those countries. The building of houses may be regarded as the most *intensive* of all forms of cultivation of the soil, and that which is the most firmly fixed to it (Roscher).

11.—**Price of Land.**—The price which a piece of land will fetch depends mainly on two things:—

(1) The rent which it may be expected to yield.

(2) The current rate of interest.

When interest is at 4 p.c., a field which fetches £4 a year rent will be worth about £100; but if interest should fall to 2 p.c., the field would be worth £200. Thus, price of land and rate of interest vary inversely. But in England the price of land has sometimes been higher than the above rule would give, for the following reasons:—

(1) In an economically progressive society the rate of interest is likely to decline, while rents are likely to rise.

(2) The ownership of land has an intrinsic attraction, and it has social advantages, in addition to its power of yielding an income.

12.—**"Unearned Increment."**—We have seen that the progress of civilisation tends to increase the demand for agricultural produce. Apart from improvements in methods of cultivation and means of communication, the larger demand can be supplied only at a higher expense of production. The margin of cultivation will fall in both directions: inferior lands will be brought into cultivation, and more capital per acre than formerly will be profitably employed. Hence, increasing differential gains, which are transferred to Rent. Lands pay rent which previously were uncultivated, and previously cultivated lands pay higher rents. Landlords, of course, benefit by this movement, and their increased gain has been called an "unearned increment."

It has been argued that such gain is not due to any exertion on the part of the landowner, and that the State might justly and advantageously absorb it by means of taxation. But if this were done (and there are practical difficulties in the way which are not here discussed), there would be no inducement for landowners to make the so-called (but miscalled) "unearned increment."

The Ricardian rent theory, on which the "unearned increment" theory is based, assumes effective and unrestrained bargaining and competition in relation to the hiring and letting of land. Any taxation of "unearned increment" would tend to diminish the keenness of such bargaining and competition. It is because the enhanced rent does *not* quite swallow up the differential gain due to superior fertility and

situation that farmers compete for the better land. It is because the landowner hopes to get and to keep part of the differential gain that he bargains with farmers for the best rent, and competes with other landowners to get the best tenants. If the landlord were to be deprived by the State of any increment to his rent, why should he endeavour to gain any? And what would be the consequence of his not making any such endeavour? This question leads us to seek what is the service to production rendered by the landowner *as such*. It is his economic function to secure that the most advantageous lands be occupied by those who can make the best use of them. He secures the most effective distribution in space of the agents of production. And it is from this point of view that Schäffle has thus generalised the notion of "rent": "The premium paid for the most economic course taken in the interest of society in general."

We may judge of the services of the landlord to society by noting that it has been estimated that on average land in Saxony ordinary management gave per acre 20 thalers gross, $7\frac{1}{2}$ thalers net return; with greater intelligence and large capital, 60 thalers gross, 14 thalers net return. Here the farmer might prefer the lower kind of cultivation, but competition would drive him to adopt the higher, since he could thereby pay a higher rent. But if the landlord were prevented by the State from benefiting by such higher rent, he would not endeavour to obtain it, and society would lose the benefit of the greater gross return.

It is to be noted, however, that the perfect bargaining and competition assumed by Ricardo often do not exist (v., 2).

13.—**Definitions.**—Having now concluded our discussion of Rent, it may be well to review some of the leading terms that have been employed. *Rent* is the price of the hire of land. It may arise as soon as any person desires to occupy land which belongs to another. In newly-settled countries, where there is still an ample supply of land of the best quality and situation unappropriated, rent will usually not exist.

Differential Gains: different rates of profit on the sale of the same commodity in the same market at the same price, due to different degrees of efficiency in production. Such gains may be retained by Profits, or may be transferred to Wages, Interest, or Rent, according to circumstances. Their transfer to Rent is so common and important, that the term

"Rent" is often used by economists as synonymous with Differential Gains.

"*Economic Rent*" is sometimes used for Differential Gains, sometimes for that part of Rent which is due to Differential Gains.

"*Quasi-Rent*": Differential Gains which are not transferred to Rent.

"*Producers' Surplus*": Differential Gains.

QUESTIONS AND NOTES.

1. Show that the rent of land is regulated by the excess of its produce above that which would be produced on the worst land in cultivation with the same expenditure of labour and capital. (*Cert.*)

2. How is the rent of land determined? Give some of the causes which have depressed English agriculture during the last ten years. (*Cert.*)

3. Give a short but clear statement of Ricardo's doctrine of Rent. Is it a confutation of his doctrine that rents are paid for uncultivable land, such as deer forests, grouse moors, &c.? (*Cert.*)

4. State and discuss any theory of Rent with which you are acquainted. (*Cert.*)

5. "The rent of agricultural land does not enter into those expenses of production to which the value of agricultural produce in general conforms." Paraphrase this statement, and give the train of reasoning by which it is maintained. (*Cert.*)

6. State and explain Ricardo's theory of rent. What confirmation or refutation has been given to this theory by the fall in agricultural rents in England of recent years? (*Cert.*)

7. "The tendency of interest to fall as society advances may be contrasted with the tendency of rents to rise." Criticise this statement. (*Cert.*)

8. Describe the influence of an increase in the population of a country on rent. (*L.C.C., Jun.*)

9. Explain and examine the statement that "rent does not enter into the cost of production"; with special reference to more recent economic speculation. (*A.S. of Taxes.*)

10. What do you understand by the conception of the "unearned increment"? How far is it theoretically justified, and how far is it applicable to actual facts? (*A.S. of Taxes.*)

11. Define Economic Rent. State and classify the various forms of Quasi-Rent; and show the importance of the element of Time in reference to the determination of what is, or is not, true Economic Rent. (*B.I., Fin.*)

12. Define Economic Rent. Briefly indicate the extension given by modern economists to the Ricardian use of the term; and contrast the practical or political consequences of the modern view with those drawn by Socialists and others from the teaching of Ricardo. (*B.I., Fin.*)

13. Set forth Ricardo's theory of rent, and state the conditions on which it holds good. To what other economic phenomena has this theory been applied, and on what grounds? Show what the different cases have in common. (*B.I., Prel.*)

CHAPTER XXI.

PROFIT.

1.—Profit is that part of the sale price of his commodity which the employer retains for himself, after discharging all other expenses of production. In those other expenses of production we must include rent for the employer's own land, wages for his own labour, whether of superintendence or of any other kind, and interest on his own capital, if used in the business. Profit, as a share in distribution, is the remuneration of Enterprise, and the hope of it is the inducement to undertake the risk which is inseparable from production. It is not properly to be described as Insurance. The object of insurance is to obtain an indemnity, *i.e.*, to secure merely that no loss shall be incurred from a particular cause. If a man insures goods worth £100 against fire, and they are burnt, and he receives £100 insurance money, he gets an indemnity, he suffers no loss, but he makes no profit on the transaction. The employer's profit must be larger than would be merely sufficient to make up to him in the long run, for the losses incurred from time to time. If it did no more than that, it would not be worth his while to risk his property or his exertions.

2.—**The Function of the Employer.**—There is a clear distinction between undertaking the risk and responsibility involved in all business, and putting forth those exertions of mind and body which are involved in directing the operations of a business organisation. Both functions may be, but are not necessarily, discharged by the same person. The latter may be, and often is, paid for at an agreed rate, and in that case the person discharging it belongs to the class of Labourers, not Employers. It is the assumption of the Risk of business that marks out the employer, and is remunerated by profit. There can be no such thing as hiring a man to take the ultimate risk of business. Whoever does in fact take that ultimate risk, on whatever terms, is the employer.

The expectation of profit is the mainspring of modern industrial activity. In vain are Labourers of all grades willing to work, and Capitalists and Landowners willing to lend their money and their land, if no one can be found who is ready to guarantee them the price of their commodities,

himself taking the risk of gain or loss on the whole undertaking.

We have seen (xix., 6) that the bulk of Profit consists of Differential Gain. This element also largely contributes to Wages of Superintendence, whether they be earned by the employer or by a paid manager. The more complex the operations of production become, the more highly and delicately organised is the economic machinery of society, the rarer becomes the ability to manage large concerns successfully, and the greater the differential gains which the abler business-managers can secure.

When in one individual there meet differential gains due to Enterprise and to Personal Ability, the total income usually called Profit may be enormous. These great gains, however, are not made at the expense of the Consumer, nor at that of Wages or Interest, since, *ex hypothesi*, there are other employers paying the same Wages and Interest, selling at the same price, and making no more than the "normal" or "natural" rate of profit.

The jealousy, therefore, which is sometimes exhibited of the employer's gains is often ill-founded. As Prof. F. Walker says:—"It is solely because of the importance of the entrepreneur function that the employing class is enabled to realise those large profits. . . . The true controversy is not between the labourer and the capitalist, but between the labourer and his employer, to whom labourer and capitalist alike are compelled to resort for the opportunity to produce wealth and to derive an income. . . . To labourer and capitalist alike he guarantees a reward at a fixed rate, taking for himself whatever his skill, enterprise and good fortune shall secure."

3.—**The Rate of Profit.**—Just as differential gain fails to account for the whole of rent, so it fails to account for the whole of profit. After putting it on one side, there remains a "normal" rate of profit, such that if less be realised an employer will cease to produce.

It is more difficult to ascertain actual rates of profit than to ascertain actual rates of wages, interest, or rent, since profit is not a price. But inasmuch as the distinctive function of the employer is to undertake risk, we must assume that normal profit will vary from trade to trade, from place to place, and from time to time, as risks vary, allowance being made for variations in the willingness to incur risk. In undertaking production there is always risk of losing capital, and usually risk of losing labour as well. We may assume, therefore, that, other things being equal, normal profit will be proportional to capital risked in the business.

In the next chapter we shall see reasons for concluding that changes in rate of interest usually correspond with changes in rate of normal profit. We, therefore, infer from the well-marked tendency of rate of interest to fall with economic progress that there is also a tendency for the rate of profit to fall under similar circumstances. And this inference is confirmed by other considerations.

It has been said that "the profits on equal capitals tend continually to equality in trades which involve equal risks, discomforts, and exertions; and which require equally rare natural abilities and an equally expensive training." The references to "equal capitals" and to "natural abilities" seem to show that "profit" is used to include Interest and Wages of Superintendence as well as Profit pure and simple.

But the statement may be accepted as applying to pure profit. We may include in the notion of "risk," not only the probability of loss of capital, but also that of loss of social position, &c., involved in engaging in trades which are looked on with disfavour.

4.—**Profit and Rent.**—We have seen that differential gains form a great part of profit. It has, therefore, been said that rent enters largely into profit, or that there is a great analogy between profit and rent; "rent" being used in the sense of "differential gain" (xx., 13).

5.—**Other Meanings of "Profit."**—The word "profit" is used ambiguously. F. Walker thus defines it:—"the gain made by sale of produce or manufactures, after deducting the value of the labour, materials, rent, and all expenses, together with the interest of the capital employed." This definition agrees with ours, if in the labour we include that of the employer himself, whether of mind or body, and in the interest and rent include payments for capital and land belonging to him.

A. Marshall says that in the revenue of the employer there are three elements—Interest, Insurance, Earnings. Here, Insurance is the element which we call profit, but, as pointed out above, insurance is not a proper term for it. Some

writers have said that the profits of the employer could be analysed into Interest on Capital and Wages of Superintendence. This ignores profit proper altogether. The insufficiency of the analysis is seen when we consider the fact that in many cases an employer has a manager who does all the work and earns all the wages of superintendence. The employer himself may know nothing of the business and do nothing in it and yet derive from it a handsome revenue. To what can we ascribe such revenue? Clearly to the only service to production which such an employer renders—*viz.*, taking the risk. This he really does, for if the business should, instead of a profit, make a loss, the whole of that loss will fall on him.

6.—**"Dividends."**—The exact nature of profit may be seen by considering the distribution of the takings of a trading company. In the first place, all expenses of production have to be met—rent of land occupied, wages of labour employed, including salaries of directors and managers, and interest on borrowed money. The residue, called "dividends," is divided among the shareholders in agreed proportions. This is pure profit. The shareholders take it, not as remuneration for loan of land or money, nor for services rendered, but because it is theirs, the economic fruit and increase of their own property, that the hope of which induced them to risk their money in the concern.

There is a popular confusion of dividends with interest. They are usually declared at so much per cent., and interest is agreed in the same terms: a man who has disposable capital often hesitates whether to invest in the hope of dividends, or to lend at interest: and the price of dividend-bearing securities is related to the rate of interest (very much as the price of land is—xx., 11).

The differences, however, are fundamental. Interest is a price, dividends are not. Interest is due by contract, dividends are not. The lender has a legal right to the return of his principal at the agreed time. The investor or employer risks his capital, and has no legal right to the return of any part of it, independent of the success of the enterprise.

QUESTIONS AND NOTES.

1. Of what elements is Profit composed? To which of these do you ascribe the chief effect in causing differences in the rate of profit in different industries? Explain the phrase, "natural rate of profit." (*Cert.*)

The analysis which we adopt shows that profit consists of a "normal" gain, sufficient to induce the employer to assume the risks of business, *plus* (in many cases) "differential gain," due to special circumstances. Other analyses are given at xxi., 5. "Normal" or "natural" profit will vary from industry to industry as risk, &c., vary (xxi., 3).

2. Define the term profits; point out the elements of which it is composed, and thence show that at the same time there may be different rates of profit (*a*) in different industries in the same country, (*b*) in the same industry in different countries. (*Cert.*)

3. State as precisely as you can the economical meaning of the term Profit. How does the possession of a patent affect the rate of profit in a particular industry, *e.g.*, the manufacture of bicycles? (*Cert.*)

A patent gives a monopoly (xii., 3). In that case, profit does not follow the laws which are based on the assumption of competition. The monopolist's high profits resemble differential gains in that they are higher than "normal," but they differ in that differential gains are due to superior productive efficiency, whereas monopoly gains are due to restriction of supply.

4. "The rate of interest depends upon the rate of profits, but the rate of profits does not depend upon the rate of interest." Examine and discuss this statement of Mill. (*B.I., Prel.*)

5. Employers' profits have been treated by different writers as analogous to Interest, Wages, and Rent respectively. What do you consider to be their true economic character? Discuss the assertion that the fortune accumulated by a successful entrepreneur has cost his country nothing. (*B.I., Prel.*)

The latter assertion, of course, should be confined to "differential gain." As to that, since the price of the product sold by the employer would have been no lower had it not been obtained, consumers (who are referred to as "his country") have not suffered.

6. "The profits of stock are altogether different, and are regulated by quite different principles from the wages of the labour, inspection and direction" (Adam Smith). "The three parts into which profit may be considered as resolving itself, may be described respectively as interest, insurance, and wages of superintendence" (J. S. Mill). "Profits are of the same genus as rent" (F. A. Walker). Can these different definitions be reconciled? What light do they throw on (*a*) the history of economic theory, (*b*) changes in the organisation of industry? (*A.S. of Taxes.*)

The three definitions indicate the increasing accuracy of economic analysis. And this has been made possible by the increasing specialisation of economic functions in actual business. In Adam Smith's time it was usual for employers to themselves work in their business, with their own capital. It is a modern development for business to be carried on largely with borrowed capital. Hence, economic theory has been led to sharply distinguish between the "capitalist" function and the "employing" function.

Again, when Mill wrote, joint-stock enterprise (xxi., 6) was in its infancy. The first general Companies Act was not passed until 1862. Joint-stock business shows us clearly the distinction between the "employing" function and the "managing" function.

Ricardo's "Rent Theory" has now been generalised into the theory of "Differential Gain," which is seen to be an element not only in Rent proper, but also in Wages, especially of Superintendence, and in Profit.

7. How far is it correct to represent profits and wages as tending to an equality in different occupations? What are the main circumstances which may occasion (*a*) temporary, (*b*) permanent differences in the wages and profits of different occupations? (*A.S. of Taxes.*)

8. What is precisely meant by the statement that "wages and profits tend to an equality in different occupations"? With what limitations is the statement theoretically accurate, and verified in actual fact? (*A.S. of Taxes.*)

9. Into what elements may gross profit be analysed? Show the importance of a correct analysis for (*a*) the theory of equality of profits; (*b*) the doctrine of the tendency of profits to a minimum; (*c*) the taxation of profits. (*A.S. of Taxes.*)

CHAPTER XXII.

INTEREST.

1.—Interest is the price paid for the temporary control of capital in general. If any particular form of capital is borrowed, *e.g.*, a machine, we call the payment for its use, not "interest," but "hire" or "rent." And since the control of "capital in general" is to be obtained most easily, by means of money, and practically in no other way, there is no great error in saying that interest is a payment for the loan of money, using "money" in a wide sense, *i.e.*, for purchasing power in general, and not confining it to legal tender.

2.—**Gross and Net Interest.**—The rates of interest actually paid at the same time in the same place vary within very wide limits. The Bank of England is usually debtor in respect of some £40,000,000, which is lent to it free of interest. At the same time loans are being made in London at all rates, from sometimes less than 1 p.c. up to 60 p.c. and more.

As to the upper limit, it may be said that perhaps no rate much over 10 p.c. is paid for money regularly employed in business. Higher rates indicate sheer recklessness, or desperate efforts to avoid impending ruin, and may conveniently be referred to "usury" as distinguished from "interest."

If we can find cases where money is lent purely for the sake of the interest, and where lenders consider that there is practically no risk of losing their money, we may regard the rate paid as "net" interest. Such rate is considered to be indicated by the rate of return to money invested in Consols. Thus, when the 2¾ Per Cents. stand at par, *i.e.*, £100 is the price of an annuity of £2 15s. 0d., Net Interest is said to be

2¾ p.c.; and if the price of the stock goes up or down, Net Interest is considered to vary in inverse proportion (xvi., 6).

Where there is risk of losing the capital advanced, the lender will charge a higher rate by way of insuring against such risk. Another mode of insuring against this risk is by lending for a short period (xv., 3). "One of the chief symptoms of an impending commercial crisis is a rapid succession of forced sales at a loss by those who have been trading with capital borrowed for short periods;" in consequence of the calling in of the loans.

The lender must also be remunerated by the interest for any trouble there may be involved in making the advance.

The difference, therefore, between Gross and Net Interest is accounted for by—

(1) Insurance against Risk;
(2) Remuneration for Labour of Management.

3.—**Interest and Profit.**—We have seen that profit is the employer's remuneration for risking his capital, and that it, therefore, bears some proportion to that capital. When an employer obtains the control of capital which is not his own, he may be willing to hand over to the owner the whole of the increased profit due to the increase of capital. Such an arrangement would usually be a partnership, but might be a mere loan. The more convenient and usual form is for the borrower to pay the lender an agreed percentage on the amount of the loan for the use of it. The borrower, on his side, hopes that the percentage will not swallow up the whole of the increase of profit due to the increase of his capital. The lender, on his part, is willing to take less than what would be a full partnership share, in consideration of running less than the full partnership risk. He has the security of the borrower's personal liability to repay, whatever the result of the enterprise. Hence, the lender runs less risk than the employer, and, therefore, the rate of interest is necessarily lower than the rate of profit. But the two tend to equality, making allowance for difference of risk. The distinction, therefore, between interest and profit is that the former is due in consequence of a bargain, and at an agreed rate, and is therefore a price, while the latter is not due in pursuance of any bargain, and is therefore not a price.

4.—**Abstinence and Waiting.**—Since capital is the

result of saving (xvi., 6), interest is sometimes said to be the reward of abstinence; and since capital enables production to be carried on by processes which give a large product, but require a long time for their operation, interest has been called the reward of waiting. Abstinence and waiting are the cost of production of capital.

5.—**Supply of Capital.**—As foresight, prudence, desire for comfort and leisure, and ambition of various kinds, increase, the habit of saving also increases. Unless economic development is well advanced, saving takes the form of hoarding. Even at the end of the 17th century, in England, old-fashioned people still kept their savings in strong boxes in their own homes. Pope's father did so years after the foundation of the Bank of England.

The practice of hoarding usually indicates a low degree of security against either external or domestic enemies. Where there is a feeling of security, men are glad to entrust the keeping of their hoards to others, and to pay them for the service. The Bank of Amsterdam (xv., 1) had large deposits, and made a charge for keeping them. Where money is not used as a store of value, hoards are kept in kind, as in the parable: "The ground of a certain rich man brought forth plentifully . . . And he said . . . I will pull down my barns, and build greater; and there will I bestow all my fruits and my goods. And I will say to my soul, Soul, thou hast much goods laid up for many years; take thine ease, eat, drink, and be merry."

Stores of wealth will thus come into existence quite independently of any demand for their aid in production, and without such demand no interest is obtainable for loans, though "usury" may be practised at the expense of spendthrifts.

But an economic demand for loans may spring up. Employers discover that by obtaining the control of capital they can enlarge their undertakings, and thus earn greater wages of superintendence, and make greater profit. If they cannot get capital on lower terms, they will be willing to offer for it almost the whole of the increased gains due to the increase of capital. When producers thus come into the field, competing with each other for loans, a further supply will be forthcoming from persons who possess wealth, and desire to derive an income from it, without having the opportunity or inclination to employ it productively themselves. Lastly, the organisation of banking economises money, and gives the power of making loans on competitive terms to regular dealers in that commodity.

6.—**Demand for Capital.**—The demand for capital depends on—

A. The field for investment, which varies with—

(1) The density of the population.

(2) The natural resources of the country.

(3) The stage of industrial and general development.

Up to the end of the 17th century there was but little accumulation of capital in England. Saving was encouraged by the improvements in banking and currency of William III.'s time (xiv., 9; xv., 6), but profitable employment for money was slow in presenting itself. In the absence of legitimate enterprise, the South Sea Bubble of 1720 made away with some accumulated wealth, and then ensued a "glut" of capital, bringing down interest, about the middle of the 18th century, below 3 p.c. During the rest of the century, savings were unproductively consumed in warfare, and interest rose to over 6 p.c. But before the wars were finished there had begun the great series of inventions, and the "industrial revolution," which have given employment to ever-growing additions to capital.

B. The price of capital.

7.—**Rate of Interest.**—In studying the value of loans (or value of money, as it is sometimes called—x., 7) we must distinguish between the demand for money, which is constituted by the offer of commodities for sale, and the demand for loans of which we are now speaking.

The exchange-value of money is measured by the general level of prices. Here we are speaking of the hire-value of "capital in general," which is measured by the rate of interest. The two are not directly connected. Given a certain level of prices and a certain rate of interest: if prices suddenly double, then we need double as much money as before in order to obtain control of the same quantity of "capital in general," but the produce of that amount of capital will fetch double as much money as previously. Hence the rate of profit will not be affected, nor will that of interest.

Since interest is a price, we may say that the normal rate

of interest is that price of loans at which the supply is equal to the demand.

In the case of capital, as in that of the other agents of production, there is no expense of production, though there may be said to be a cost of production (xix., 3). The supply, therefore, is largely independent of the rate of interest. People will save, and even lend, though they can get no interest. But there is the same relation between rate of interest and demand for capital as in other cases of value.

Low rates of interest encourage rotten investments. It has been said that there would be no limits to commercial folly if interest were zero. On the other hand, high interest, as we have seen, means high risk.

Profit seems to be the real regulator of interest. To a large extent, loan and investment are alternative modes of productive employment of wealth. A man will deposit money in a bank at interest (loan), or he will buy shares (investment) according as he judges that the one or the other offers the best return, allowance made for difference of risk. The rate of profit, we have seen, depends on the degree of risk. On the whole, economic risk tends to diminish with economic advance, and, hence, in an economically progressive society, there is a tendency for profits and interest to fall.

8.—**Usury.**—Up to comparatively recent times in England there existed, and in some parts of the world there even yet exists, the opinion that the taking of a price for the loan of money is irreligious, or immoral, or opposed to the true welfare of society. The reasons given for the opinion seem bizarre. The taking of interest by Israelite from Israelite was forbidden. But as interest might lawfully be taken from strangers, the ground of the prohibition would seem to have been peculiar to the Hebrews.

Aristotle suggested that as gold and silver do not bring forth fruit after their kind, in the manner of plants and animals, the paying of interest is contrary to the nature of things. Shakspere refers to this argument when Antonio asks Shylock, "Is your gold and silver, ewes and rams?"

Hardly more serious than these arguments are the allegations that it is wrong to share in the profit of business, by taking interest, without sharing also in the risk by becoming a partner; or that the payment of interest permits idleness; or that the lending of money for unproductive consumption permits extravagance and leads to ruin.

The true reason of the antagonism to lending at interest seems to be that "in certain states of industrial society, the lending classes have so great an advantage over the borrowing class, which, in such states of society, consists generally of distressed persons, as practically to place an individual borrower completely at the mercy of the usurer, who is able to exact a rate of interest which is not only irrespective of the economic service rendered through the loan, but soon becomes destructive of the borrower's credit and financial integrity" (F. Walker).

No such objection applies where the borrowing is for the purposes of business, and, therefore, as the modern period of economic history developed, the objection to interest faded away.

In his "Defence of Usury," Bentham gave the *coup de grace* to the theory of restriction of interest, but such restrictions were not removed until 1854 (xv., 1).

The real distinction between objectionable and unobjectionable lending seems to lie in the object of the loan. If it is for business purposes, and conducted on business principles, there is no reason why the parties should not fix the terms of their bargain themselves. But when money is borrowed under the spur of want or prodigality, and not on business principles, the borrower is apt to offer terms which he has no reasonable expectation of being able to comply with, and suffering and discontent inevitably follow. It is doubtful, however, whether the law can do any good directly by interfering between would-be borrower and lender. "Usury laws" can be evaded in many ways, and the cost of the evasion falls on borrowers.

The "Money-lenders Act, 1900," compels persons who carry on business as money-lenders (not including bankers, or insurance and building, &c., societies) to be registered, and authorises law-courts to set aside harsh and unconscionable money-lending bargains.

QUESTIONS AND NOTES.

1. Explain the statement that Gross Interest does not tend to equality as Net Interest does.

2. What determines the Rate of Interest in a country? Why has this been so abnormally low in the English money market for some months past? (*Cert.*)

3. What considerations should be chiefly borne in mind in the investment of small savings? Give examples from History of the folly of an

ignoran public attempting to combine a high rate of interest with safety of capit l. (*Cert.*)

4. Discuss the advisability or practicability of limiting by legislation the rate of interest charged by money-lenders. (*L.C.C., Jun.*)

CHAPTER XXIII.

WAGES.

1.—Wages is the price paid by the employer for the labour which is necessary to Production. We may speak either of buying labour or services, or of hiring human beings for certain definite purposes. The employer may himself work in his business, and in that case his own labour is not exchanged. But he could, if he desired to do so, hire a manager to do the work that he in fact does, and, therefore, we may say that out of his total gains from his business, a sum equivalent to the salary which such a manager could command, is really a quasi-wage. When we speak, however, of the wage-earning class, we generally refer to the fourth of the classes of labourers given by F. Walker (iv., 6).

Wages is the most important and the most difficult topic in economics. In England, at least, wage-earners are the most numerous class of the community, and in the majority of cases they have no other substantial source of income than their wages. The "wages question," therefore, relates directly to the material welfare of the greater number of our neighbours, and we shall find, on investigation, that it is of all economic problems the one that least easily lends itself to exact treatment, since it is the one that is most largely controlled by non-economic motives.

We shall commence by taking note of certain distinctions and subsidiary considerations which will help to make our notions more distinct, and then we shall briefly review the theories of wages which have been put forward during the progress of economic science.

2.—**Nominal and Real Wages.**—In comparing the respective attractiveness of two employments, it is not enough to look merely at their respective money-wages. These are called 'nominal" wages, while real wages is the total amount of objects of desire which the labourer can ultimately obtain

as the remuneration of his services. In estimating real wages, the following circumstances must be taken into account :—

(1) **Variations in the purchasing power of money.** In newly-settled countries, money-wages are often high compared with older countries, but money-cost of living may be even higher. See ch. 17, for instances of changes in the value of money.

(2) **Variety in form of payment.** It has frequently been made a condition of employment that the labourer should take the whole or a part of his wages in "kind," *i.e.*, either :—

(i.) A portion of what he produces, as coals in the case of a miner; or

(ii.) Commodities for his own consumption; as beer or cider in the case of a harvester. As much as 50 p.c. of harvest-wages have at times been paid in this way.

Truck, as the practice is called, has been made illegal in England, on the ground that it hinders the labourer in estimating his real wages, and gives the employer an unfair advantage.

(3) **Opportunities for extra earnings.** In some parts of the country, workmen can get allotments of land at a low rent, and by cultivating them in their spare time, add to their income. Whether the effect of such allotments is to lower ordinary wages and so nullify the benefit of them, or to add to ordinary wages, is disputed. In some places the labourer's wife and children may earn money, whereas in others there is no opportunity for such earnings.

(4) **Duration of working capacity.** Some trades, such as dry metal-grinding, "china-scouring," lead working, and, by far the worst of all, dealing in intoxicating liquor, are notoriously unhealthy. Shorter life, or greater sickness, constitutes a deduction from real wages.

(5) **Regularity of Employment and chance of success.** Regularity is diminished by—

(*a*) *The seasons.* Most agricultural operations are dependent on the time of year, and extra hands are required in harvest.

(*b*) *The nature of particular occupations; e.g.*, fisheries, where employment varies in consequence both of the weather and of the habits of the fish.

(c) *Social causes*, such as the numerous saints' days and holidays observed in some countries.

(d) *Industrial causes* of a general character, such as "bad times," general trade depression, strikes, &c.

(6) **Pleasantness and social estimation.**

3.—**Time and Task Wages.**—The labourer may be paid so much per week or day, or so much per piece of work done. It is usually to the advantage of the employer that time-wages should rise, if task-wages remain stationary, since there will then be greater economy in the use of auxiliary capital. Unless otherwise stated, by wages is to be understood real-, time-, wages.

4.—**Real and Nominal Cost of Labour.**—This is a distinction, from the employer's point of view, akin to that between real and nominal wages from the labourer's point of view. The nominal cost of labour is the price paid for it. The real cost of labour is the proportion between the wages paid and the increased value of the product due to the labour.

"From superior skill or greater energy, the more highly-paid workman will in many, perhaps in most, cases turn out a greater amount of work, in proportion to the wages he receives. An opportunity occurred some years ago, during the construction of the refreshment room at Basingstoke, for testing this problem with great accuracy. On one side of the station a London bricklayer was employed at 5/6 a day, and on the other two country bricklayers at 3/6 a day. It was found, by measuring the amount of work performed, without the knowledge of the men employed, that the one London bricklayer laid, without undue exertion, more bricks in a day than his two less skilful country fellow labourers.

"On the Grand Trunk Railway a number of French-Canadian labourers were employed. Their wages were 3/6 a day, while the Englishmen received from 5s. to 6s. a day, but it was found that the English did the greatest amount of work for the money. The same remarkable tendency to equality of cost exhibits itself even in India. On the Delhi and Umritzir Railway it has been found . . . that, mile for mile, the cost of railway work is about the same in India as it is in England; although the wages, if estimated by the amount of daily pay, are marvellously low . . . . . The wages

paid on the Delhi and Umritzir Railway were: Masons, 10 to 12 rupees a month; carpenters, 15 to 18; bricklayers, 8 to 12" (Brassey, *Work and Wages*).

5.—**Bargaining for Wages.**—It sometimes happens that the labourer is at a disadvantage in bargaining with the employer, and therefore accepts lower wages than he might have got by greater insistence. Employers are fewer and richer, and usually better informed than their labourers. As a rule they can wait, and the labourer often can not. They are bargaining for a higher profit; the labourer is bargaining for the means of life.

The following circumstances favour the labourer in bargaining for wages:—

(1) The employer's interest in continuity of production, and, therefore, of employment. There is always loss involved in change, and frequently a labourer acquires special value to his employer from his knowledge of the particular business, and mutual adaptation from long acquaintance;

(2) Frugality and saving, enabling him to seek his best market, and to stand out for good terms;

(3) Intelligence and self respect;

(4) Legal regulations, calculated to secure the labourer's freedom and independence (xxix., 8).

The following circumstances are opposed to the labourer in bargaining for wages:—

(1) Restraints on movement and contract;

(2) Injudicious poor laws (ch. xxx.);

(3) Unfair incidence of taxation;

(4) A bad monetary system;

(5) The form in which wages are paid.

6.—**Degradation of Labour.**—Even in the case of material commodities, fluctuations of prices are on the whole injurious. But in the case of wages, fluctuations may be fatal, if they are so great as to produce "degradation" of a class of labourers; *i.e.*, their permanent reduction to a lower economic level. A labourer who is out of work for a considerable time will generally become less capable of earning his original wages. He may suffer privation and irreparable loss of strength, or diminution of energy and diligence and technical skill. The trade depression which threw him out of work

may pass away, and opportunities occur for renewed employment, but he may be no longer able to profit by the change.

Even without absolute loss of work, a protracted season of very low wages may produce similar results.

Degradation of this kind may be caused by :—

1) The concerted action of employers in refusing to pay a wage which is sufficient for maintaining productive efficiency.

2) Changes in methods of production. When Bessemer invented his new method of making steel, 39,000 men who had been engaged in making bar iron in puddling furnaces were thrown out of employment.

3) Catastrophes in business, such as occur in times of panic.

7.—**The Iron or Brazen Law**.—We now pass on to consider the economic theory of wages. This theory has developed historically, as have other economic theories (ii., 5), and a brief review of its development will bring before us its various elements in the most convenient way.

The earliest theory of wages which we need notice was propounded by the Physiocrats, who generalised the state of things they saw in France, and assumed that there is a "natural law" of population according to which the wages of labour are kept at starvation limit. If wages temporarily rise, the numbers of labourers increase and force wages down. If wages temporarily fall, some of the labourers starve, and wages are forced up. In England, facts were always against the law, and prevented it being adopted, although several English economists, Ricardo especially, have been supposed to give it countenance.

The element of truth in the theory is that labourers do not come into existence by virtue of the economic motive. Like the other agents of production, their supply is not entirely regulated by the price, *i.e.*, by the wages they will be able to earn. Taking the yearly average of births per 1000 population during the period 1871-97, in the various countries of Europe, we find the lowest figure in France, which was certainly not the poorest country in Europe, and the highest in Hungary, which was certainly not the richest, and a greater number in Italy than in England.

The law of the supply of labour, then, is not an economic law. But the law of the demand for labour is an economic law, and therefore subject to diminishing utility (iii., 4; viii. 6). Hence, if the numbers of labourers should increase faster than demand increases, wages will fall, and there is no limit to the fall but starvation or emigration.

8.—**The Wage-Fund**.—Adam Smith made the pregnant observation that the liberal reward of labour "increases the industry of the common people," and that "a plentiful subsistence increases the bodily strength of the labourer; and the comfortable hope of bettering his condition, and of ending his days, perhaps, in ease and plenty, animates him to exert that strength to the utmost. Where wages are high, accordingly, we shall always find the workmen more active, diligent and expeditious, than where they are low." But the suggestion remained barren for nearly a century, and the accepted doctrine was the wage-fund theory of Malthus, James Mill, and his son, John Stuart. The theory is thus stated by the latter writer: "With these limitations of the terms ["capital" means capital devoted to the payment of wages; "population" means those who work for hire] wages not only depend upon the relative amount of capital and population, but cannot, under the rule of competition, be affected by anything else. Wages [meaning, of course, the general rate] cannot rise, but by an increase of the aggregate funds employed in hiring labourers, or a diminution in the number of the competitors for hire; nor fall, except either by a diminution of the funds devoted to paying labour, or by an increase in the number of labourers to be paid" (*Principles*, ii., 11, § 1).

To the extent to which the theory can be supported, it is merely a statement of an obvious fact, *viz.*, that the average rate of wages is ascertained by dividing the total paid in wages by the number of wage-earners.

The Theory was attacked by Longe and Thornton, and, after a time, abandoned by Mill himself.

The objections to it are :—

(1) It disregards the efficiency of the labourer. As this varies so will vary the quantity and quality of the total output, and such variations cannot but affect real wages.

(2) It treats the quantity of remuneratory capital as fixed independently of the number or quality of the labourers. But within limits, which are very wide, employers will devote more or less capital to the remuneration of labour, according to the probable profitableness of so doing, and this will depend partly on the numbers of the labourers and partly on their efficiency.

9.—**Standard of Comfort.**—In 1798 appeared the "Essay on the Principle of Population" (ii., 5).

Under favourable conditions, human beings can double their numbers in 25 years, and in the absence of certain definite circumstances, they will actually exercise the power. It is obvious that multiplication at that rate has not gone on, and could not go on without check, since otherwise the earth could not furnish even standing-room for the multitudes that would come into existence in a comparatively short time. In his essay, Malthus showed historically that population has been kept down by two classes of causes:—

(1) Positive checks, such as disease, war, famine, which operate by destroying the redundant population;

(2) Preventive checks, such as delaying the time of marriage, and celibacy, which operate by preventing a redundant population from coming into existence.

One way of stating Malthus's conclusion is that population tends to increase faster than means of subsistence. Another, and apparently more, but really less, exact statement of it is, that while population tends to increase in a geometrical ratio, means of subsistence tend to increase in an arithmetical ratio.

Some American writers, misled by the apparently boundless expanse of fertile soil which they saw around them, have attacked the doctrine, and ridiculed the notion that human beings tend to increase faster than cabbages and potatoes. English economists, on the other hand, who held the Wage-Fund theory, urged on the labouring classes a voluntary restriction of the number of their children, as the only direct mode in which they could gain permanently higher wages. In this discussion they introduced the term "Standard of Comfort." In each social class there is a style of living recognised as the minimum possible for that class, and the majority of young persons belonging to the class will not marry unless and until they can see their way to bringing up their probable family in that style called the standard of comfort for the class. The means, therefore, on which the wage fund economists relied for improving the conditions of the wage-earners was the raising of their standard of comfort. It was in that view that a comparatively expensive diet was thought more to the interest of the labouring-classes than a comparatively cheap diet, and that dear necessaries and cheap comforts were recommended.

The modern development of the notion of standard of comfort will be best traced after we have noticed the successor of the wage fund theory.

10.—**The Efficiency Theory.**—The great advance which has been made on the theories hitherto examined is the recognition of the relation between the efficiency of labour and the rate of wages. "Production," says F. Walker, "furnishes the true measure of wages." The labourer is no longer stupefied by being told that he can never permanently earn more than starvation-wages, or that he can only improve his condition, while remaining a mere labourer, by racial self-effacement; but he has scientific warranty for the common-sense opinion that if he becomes a more efficient producer, he may himself reap a fair share of the resulting increase in the harvest.

Prof Marshall thus sums up his theory of wages: "We see that demand and supply exert co-ordinate influences on wages; neither has a claim to predominance; any more than has either blade of a pair of scissors, or either pier of an arch. Wages tend to equal the net product of labour; its marginal productivity [xx., 4] rules the demand price [price bid] for it; and, on the other side, wages tend to retain a close though indirect and intricate relation with the cost of rearing, training and sustaining the energy of efficient labour" (*Economics of Industry*).

With regard to the latter part of this statement, there can be no doubt that the tendency mentioned does in fact exist. But we have seen reason to believe that the price of labour (*i.e.*, the rate of wages) has but little effect on the supply of labour.

11.—**Standard of Life.**—On the side of demand, there is no doubt that the theory of value applies to wages. Human services are bought for productive consumption under conditions of varying return. Supply may outrun demand, and, if so, price (*i.e.*, rate of wages) must fall.

On the side of supply, expense of production, the regulator of the supply of commodities other than the agents of production, is non-existent, and its place is ill-supplied by cost of production (xix., 3). What general account can we then give of the supply of labour? The answer seems to be furnished by a development of the theory of standard of comfort. There

is a tendency for every man to refuse at all hazards to sell his services for less than will enable him to maintain his accustomed mode of living, and by way of distinction from standard of comfort, which has acquired the peculiar meaning above given, we may call this notion the standard of life. It directly affects wages, whereas, standard of comfort only indirectly affects them by acting on the number of possible competitors for wages. In France we see an almost stationary population, whose growth is, perhaps, restrained by the fear of lowering the standard of comfort. But the result is that France is decreasing in relative power and importance. Meanwhile the English and German races are rapidly increasing in numbers and power, and at the same time raising their standard of life.

A labourer whose wages are insufficient to give him what he regards as the necessaries of life, will, if he have sufficient energy and the opportunity, refuse to work at that rate, and seek a better market. He may migrate to another trade or another neighbourhood, or he may increase his efficiency by greater attention and study, or by combination with his fellows, or otherwise, he may increase his capacity to make an advantageous bargain with his employer; and if his powers and opportunities adequately second his ambition, he may succeed in bettering his position without the necessity of checking that increase of population which is desirable for an indefinite time yet to come, in the case of the more advanced races.

In India we have a population without the standard of life of the English or the standard of comfort of the French. There the growth of population is checked only by the difficulty of keeping body and soul together. The "positive checks" of famine and pestilence operate periodically, and wages are usually at starvation point.

The meaning may now be clearly seen of the statement that "Character makes the rate of wages.' This gives the clue to all wage-problems, though it must be remembered that here, as elsewhere in economics, cause and effect are reciprocal, and there is some truth in the proposition that "The rate of wages makes character." But it is now well recognised that in regard to every force acting on the working-classes, the most important question is, What is its effect on character? The question is as important in economics as it is in religion, morals, or politics. Whatever tends to raise character will tend to raise wages, and whatever tends to lower character will tend to lower wages.

QUESTIONS AND NOTES.

1. Explain why wages differ (*a*) between workmen in different occupations, (*b*) between workmen in the same occupation in different districts. Which of these differences tend to diminish, and why? (*Cert.*)

2. Illustrate the statement that uncertainty of success has considerable influence in regulating the remuneration of any employment. (*Cert.*)

3. Investigate briefly the effect upon Wages of (*a*) cheapening the necessaries of life, (*b*) improved means of communication, (*c*) invention of machinery, (*d*) influx of foreign labourers. (*Cert.*)

4. "Labour resembles commodities." "Labour differs from commodities." Describe the points of agreement and difference, and show the importance of the latter to the labourers. (*B.I., Prel.*)

5. "The produce of labour constitutes the natural wages of labour." Examine this statement critically, and show the various senses in which it may be taken. How far does it support the claim of the socialists? (*A.S. of Taxes.*)

6. During the year 1890, wages generally have risen. Discuss the question as to the causes of this rise. (*Cert.*)

7. Is highly paid labour necessarily dear labour? In your answer deal with the comparative wages paid to European and Asiatic labourers. (*Cert.*)

8. State the theory of population enunciated by Malthus. To what extent was it suggested by the particular circumstances of his own time, and in what respects have subsequent experience and investigation tended to confirm or to weaken his reasoning? (*A.S. of Taxes.*)

9. Give an account of the Wages Fund Theory of Mill and other economists. What arguments have been used against it? (*Cert.*)

10. "A rise in the wages of any trade affects the interests, not only of their employers and of the consumers of the commodity which they help to produce, but also of the trades which are associated with them in producing it." Examine and illustrate this. (*L.C.C., Sen.*)

"Suppose that the supply and demand for building being in equilibrium, there is a strike on the part of one group of workers, say the plasterers, or that there is some other disturbance to the supply of plasterers' labour. In order to make a separate study of the demand for that factor, we suppose firstly that the general conditions of the demand for new houses remain unchanged; and secondly we assume that there is no change in the general conditions of supply of the other factors, two of which are, of course, the business faculties and the business organisations of the master builders. Then a temporary check to the supply of plasterers' labour will cause a proportionate check to the amount of building: the demand price for the diminished number of houses will be a little higher than before; and the supply prices for the other factors of production will not be greater than before. Thus new houses can now be sold at prices which exceed by a good margin the sum of the prices at which these other requisites for the production of houses can be

bought; and that margin gives the limit to the possible rise of the price that will be offered for plasterers' labour, and on the supposition that plasterers' labour is indispensable.

"It is, however, important to remember that if the supply of one factor is disturbed, the supply of others is likely to be disturbed also. In particular, when the factor by which the supply is disturbed is one class of labour, as that of the plasterers, the employers' earnings generally act as a buffer. That is to say, the loss falls in the first instance on them; but by discharging some of their workmen and lowering the wages of others, they ultimately distribute a great part of it among the other factors of production" (A. MARSHALL, *Economics of Industry*).

11. Adam Smith tells us that "wages vary with the ease or hardship, the cleanliness or dirtiness, the honourableness or dishonourableness, of the employment." Give instances of this, and show how other considerations limit the operation of the law. (*Cert.*)

The lowness of the wages of ordinary clerks is partly due to the comparative ease, cleanliness, and honourableness of their employment.

Prof. Marshall calls it an "evil paradox" that "the dirtiness of some occupations is a cause of the lowness of the wages earned in them. For employers find that this dirtiness adds much to the wages they would have to pay to get the work done by skilled men of high character working with improved appliances; and so they often adhere to old methods which require only unskilled workers of but indifferent character, and who can be hired for low (Time-) wages, because they are not worth much to any employer."

12. Prove by illustrations that the rate of wages is principally regulated by competition, and name some of the circumstances which practically modify the action of competition. (*Cert.*)

13. How far does the element of monopoly enter into and explain the differences of wages? Do these differences tend to increase or diminish under existing social conditions? (*B.I., Prel.*)

14. Show the truth of the statement that wages are increased by increasing the produce of labour. How is this compatible with the present over-production in the iron-trade? (*Cert.*)

Study the diagram (iii., 3). If the Labour spent on commodity A becomes more productive, there will be a greater quantity of produce to to be divided among producers of commodity B. This may mean that A falls in value relatively to B. Still, the producers of A are no worse off than before, and the producers of B are better off. While if the labour spent both on A and on B becomes more productive, the real wages of both sets of labourers will rise.

This illustrates the benefit which labourers get as consumers from an increase in the efficiency of labour. They will also benefit as producers, by an increase in their efficiency, by the increase in the total value of their output, unless price falls so low, in consequence of the increased supply, that total value is less at the lower price and greater quantity than it was at the higher price and smaller quantity.

'Over-production" is different from an increase in efficiency. It means that so much of a commodity has been produced that its price falls below expense of production, with consequent loss to employers, and diminution of employment to labourers. It indicates that effort has been mis-applied, in producing commodities which are not much wanted.

The relation between price and expense of production is the regulator which guides productive effort in the directions in which it is most useful to society.

15. Examine briefly the effects, immediate and ultimate, of the introduction of labour-saving machines on the wages of labour. (*Cert.*)

Study diagram (iii., 3). Output of commodities is not diminished. Therefore, no one is injured immediately except the labourers who may be thrown out of employment. These will at once seek other work (while the remuneratory capital, set free from paying their wages, will also seek employment), and when they find it, the total produce of labour will be greater than before, and, therefore, real wages will rise.

SOME SOCIAL AND POLITICAL QUESTIONS INVOLVING ECONOMIC CONSIDERATIONS.

CHAPTER XXIV.

CO-OPERATION.

1.—The word "Co-operation" is used ambiguously. Sometimes it means what we have called "organisation of industry" (ch. vii.), "simple co-operation" being used for "combination of efforts," and "complex co-operation" for "separation of employments." But in a more special sense, "co-operation" means a scheme of combination for the production of wealth on a different plan from that which we have hitherto considered. The power which sets in motion the machinery of production, as we have considered it, is the employer's expectation of profit. In the hope of profit he engages land, labour, and capital, and undertakes the risk of production. But it is possible for the labourers to club together such capital as they may possess or can borrow, and undertake to produce on their own responsibility. Production on this plan is called co-operation, the method previously described being called, by way of distinction, "capitalistic," or "entrepreneur," production.

The differences between the two schemes belong partly to the head of production, partly to that of distribution.

(1) As to production, co-operation has been called "union in production upon equal terms," or "democracy introduced into labour." The advantage to the labourer is that employment is not dependent on the will of an employer, but is at his own option. On the other hand, successful business requires discipline and organisation, which are developed with

more ease and efficiency under the capitalistic than under the co-operative *régime*.

(2) As to distribution, since the whole body of labourers take the risk, they will also take the profit of the concern. Hence co-operation has been defined as "getting rid of the entrepreneur." But production without an employer is impossible. What co-operation really does is to unite the function of labourer and that of employer in the same persons. Wages of superintendence, as we have seen, is quite distinct from profit. Co-operative labourers cannot divide wages of superintendence among themselves, but they may so divide profit. Co-operative production requires skilled management as much as does capitalistic production; and one of the characteristic causes of the comparative failure of co-operative production has been petty jealousy of the manager, and unwillingness to pay him a price sufficient to attract men of the necessary ability for the post.

Cairnes described co-operation as "combining in the same person the two capacities of labourer and capitalist." If we define "capitalist" strictly, the description is inaccurate, because production may still be co-operative, though the co-operators borrow the capital with which they do business. But Cairnes used "capitalist" both for owner of capital and for employer.

Sometimes the "co-operative" system of production is contrasted with the "competitive"; but this is incorrect. Business may be co-operative and also competitive, or it may be "capitalistic" and non-competitive, as, *e.g.*, in the case of a monopoly. In fact, the greater part of co-operative business is competitive; for the practice of selling goods at market prices, and then dividing part of the profits among customers, which is usual with co-operators, is an underselling of other establishments.

In addition to the advantages above indicated, co-operation may be expected to—

(1) Do away with strikes and lock-outs.
(2) Encourage industry, care, and skill.
(3) Encourage frugality.

The great disadvantage of co-operation is its inefficiency, due to the incapacity of the labourers. They have usually not had the intellectual and moral qualities necessary to conduct business successfully, nor to submit to, and adequately remunerate, those who have such qualities.

Capitalistic employers find it pay to give their managers salaries rising to thousands of pounds per annum. Co-operators have rarely been able to bring themselves to pay a manager more than as many hundreds.

2.—**Co-operation in Consumption.** — The most successful form of co-operation is that of dealing in commodities consumed by the co-operators themselves. This is called Distributive or Consumptive Co-operation. Its advantages are—

(1) The gain of the ordinary net profits of retail trade. These are often unduly high, as also are very frequently the expenses, in consequence of the number of retail shops being unreasonably large.

(2) A saving of advertisements, &c. The amount and kind of trade are known beforehand, and a sale is secured without risk or expense. The co-operators will submit to being worse served than they would be at a capitalistic establishment. Very small business capacity, therefore, is needed.

(3) Reduction in the expense of handling and dealing out goods.

The chief obstacles in the way of co-operation are defects of character. These are at once the consequence of the conditions of the workers' lives, and a hindrance to improvement. Those, therefore, who look to co-operation as a means of improving mankind, have always put education in the front of their schemes. It is the noblest use to which to put their profits, and the condition of the realisation of their hopes.

3.—**Historical Sketch.**—The Rochdale "Equitable Pioneers" are a typical example of co-operation in consumption. The society was founded in 1844 by 28 men, with a capital of £28, collected mostly at the rate of 2d. a week. In 1888 the society had 11,223 members, and a share capital of £339,937. The sales for the year were £266,175; total profits, £46,729. Of this profit £29,370 went as dividends to members, £472 as dividends to non-members, and £816 to the Educational Department. The following description of the work and position of the society was written in 1885 (*History of Co-operation*, G. J. Holyoake):—

"The Toad Lane Store has expanded into 14 or more branches, with 14 or more news-rooms. Each branch is a ten times finer building than the original store. The Toad

Lane parent store has long been represented by a great central store, a commanding pile of buildings, which it takes an hour to walk through, situated on the finest site in the town, and overlooking alike the Town Hall and Parish Church. The Central Stores contain a vast library, which has a permanent librarian, Mr. Barnish. The store spends hundreds of pounds in bringing out a new catalogue, as the increase of books needs it. Telescopes, field glasses, microscopes innumerable, exist for the use of members. There are many large towns where gentlemen have no such newsrooms, abounding in daily papers, weekly papers, magazines, reviews, maps, and costly books of reference, as the working class co-operators of Rochdale possess. They sustain science classes. They own property all over the borough. They have estates covered with streets of houses built for co-operators. They have established a large corn-mill. . . They built a huge spinning-mill, and conducted it on co-operative principles three years, until outside shareholders converted or perverted it into a joint-stock affair. . . . . (They instituted and have maintained to this day an Educational Fund out of their profits). . . . Their original objects were large. They sought to equalise the distribution of property—to create co-operative workshops, to employ their own members, and support them on land of which they should be the owners, and create a self-supporting, intelligent, and prosperous community."

Co-operative Societies have grown rapidly in the United Kingdom within the past 40 years. Their total sales have risen from about 2½ millions, in 1862, to over 50 millions in 1896. In the latter year their position was—Members, 1,534,824; share capital, £18,236,040. Most of these are Consumers' Co-operative Societies.

Since 1864, Co-operative Wholesale Societies have come into existence, for supplying Retail Societies on the same principles as those on which the latter supply their individual members. To some extent the Wholesale Societies carry on manufactures, but on "capitalistic" lines, *i.e.*, they employ labourers who themselves have no voice in the conduct, and no share in the risk, of the business.

There are, however, indications that in agriculture and manufactures, co-operation is becoming more efficient. "A most promising co-partnership enterprise in London . . . is a building society under the title of General Builders, Limited.

. . . It was not allowed to start until it had obtained £1,000 of capital. It has 800 members, and employs 40 to 50 workmen, all of whom are members of the society, and sharers in profits or losses and in management. It has £2,000 of capital in shares and loans. There are one or two middle-class shareholders, but 95 p.c. of the share capital is held by workingmen. . . . The society has had a promising career. . . . Its hours are 50 a week during summer, and it was able to keep busy all last winter. Trades-union wages are paid, and sometimes a little more. . . . This society now has 17 branches in different parts of London. They have been successful enough to feel justified in building themselves an establishment for a central joinery works, which will include an educational room for lectures." (*Labour Co-partnership* [1898], H. D. Lloyd).

4.—**Profit-Sharing** or **Industrial Partnership** is a system of remunerating labour which is intermediate between the wage-system and co-operation. By piece-wages the labourer is remunerated for his services in proportion to the gross product. Under a system of co-operation in the full sense, the labourers control the productive process, and are the owners of whatever profit may be realised. They are therefore remunerated by the net product. In a profit-sharing establishment there is an employer distinct from the labourer. The control of the business rests with him, and he is entitled to the profits, but he divides part of this among the labourers as the whole or a part of their remuneration. The labourers are therefore remunerated in proportion to net product.

There is a very broad distinction between co-operation and profit-sharing. Can the "captain of industry" discharge the labourers, or can the labourers discharge their captain? In the latter case, there is co-operation, in the former there is not, at least, not to the fullest extent.

Under the "Capitalistic" system of production, it may appear to be to the labourer's interest to do as little work, and to take as little pains about it, as possible, consistently with retaining his situation. But if his remuneration, wholly or in part, is directly and visibly dependent on the profits made by his employer, he will perceive the coincidence of his own interest with that of his employer. The following

consequences may be expected to flow from a system of profit-sharing :—

(A) As regards the employer :—

(1) An increase in the quantity of product;
(2) An improvement in the quality of product;
(3) Less waste of material;
(4) Fewer disputes and less cost of superintendence.

(B) As regards the worker :—

(1) An increase in the pleasure with which he does his work;
(2) A greater reward for his services.

The employer is likely to lose nothing by offering his men a share in profits in addition to their previous wages. It may be expected that the increased efficiency of the men will *create* the profit which will be divided among them.

It is sometimes objected to profit-sharing that it is not also "loss-sharing." If the employer, in good times, divides his extra profits among his men, what is to compensate him when bad times come, and he makes less than usual profits, or even a loss? The difficulty, however, is not insurmountable: "An encouraging illustration may be cited from the experience of William Thomson & Sons, Limited, of Huddersfield, an 'industrial partnership' which was inaugurated with the help of Trade Unionists and co-operators. In 1889, owing to exceptional circumstances, there was a clear loss on the year's trading. In this case the workers, so far from being disgusted with the result, voluntarily agreed to pay out of their wages during the succeeding year a sufficient sum to pay the interest on the fixed capital; this was actually done by the payment of a voluntary tax of about 6d. in the £ on wages for the necessary number of months" (*Profit-Sharing*, BUSHILL [1893], 148).

Another objection comes from Trade Unionists. "Industrial divisions," said JEVONS, "should be perpendicular, not horizontal. The workman's interests should be bound up with those of his employer." Trade Unionists, especially those with Socialistic tendencies, desire, on the contrary, to make industrial divisions horizontal, not perpendicular, and therefore dislike profit-sharing, because it tends to render the interests of the workmen identical with those of their employer.

One of the earliest and best known instances of profit-sharing is that of the Maison Leclaire. M. Leclaire, a Parisian house-painter and decorator, began to admit his workmen to

participation in the profits of the business in 1842. He was a man of remarkable energy and ability, qualities which he utilised first in establishing a good business, and then in improving the condition of his workmen. His scheme was entirely successful, and has been continued since his death in 1872. In 1842, £490 was shared among 44 persons engaged in the business. In 1883, £9,000 was shared among 838 persons. Leclaire himself left a fortune of £48,000, and declared that he could not have accumulated so much, even by fraudulent means, had it not been for the establishment of participation.

Another profit-sharing experiment to which reference is frequently made, is that of Henry Briggs, Son, & Co. Messrs. Briggs were colliery-owners in Yorkshire, and in 1865 they introduced profit-sharing among their men as a last resort to retrieve the fortunes of the business, which had been almost ruined by disputes between the firm and their labourers. The proposal was to apportion profits thus: make an allowance first, for the usual reserve fund; second, for 10 p.c. dividend on capital; third, for salary of management; and then, divide the remaining profit half to the shareholders and half to the workpeople. Up to 1875 the scheme was completely successful. JEVONS said of it, "the Whitwood collieries seem to me to furnish all the requirements of a perfectly decisive experiment." The following were the results during the first six years, which was a period of average prosperity in the trade: A regular dividend to capital of 10 p.c. (it had averaged scarcely 5 for the preceding 10 years); a bonus to capital of $5\frac{1}{8}$ p.c., and a bonus of equal amount to labour. In addition to the pecuniary results, the feelings of distrust, opposition, even hatred, which prevailed between masters and men before 1865, disappeared, and were in a few years replaced by respect, friendship, and affection.

The scheme, however, was destroyed by good fortune. A period of great activity in the coal trade commenced in 1871. By the 30th June, 1873, wages had risen 50 p.c. on the original rate, and to correspond with this rise the rate of interest on capital was raised from 10 to 15 p.c. In 1874 the price of coal fell, and wages were reduced. A general strike against this reduction took place in the district, and the workmen at the Briggs' collieries joined. Thereupon the shareholders, thinking that such conduct was contrary to the

principles of profit-sharing, resolved, in 1875, to discontinue the practice.

It would be a mistake to regard this experiment as a failure. It was a complete success, and its discontinuance was due to exceptional circumstances, and lack of experience in dealing with them.

Some highly successful business enterprises are being conducted at the present day in this country on the principle of profit-sharing. We may mention the South Metropolitan Gas Company, which in 1899 paid £20,000 to their 2,800 shareholder employees as their share of profits. The relations between the Company and its workpeople are good, and gas is produced and sold very cheaply.

QUESTIONS AND NOTES.

1. Profit-sharing between employers and employed has been advocated as an improvement on the wages system. Point out what you think are its advantages and defects, and give a brief account of any experiments which have been made in this direction. (*Cert.*)

2. What is meant by an Industrial Partnership? State what you know of the history of this method of preventing trade disputes, and criticise its efficiency. (*Cert.*)

3. "Co-operation is a scheme by which the labourer can unite the functions and earn the wages of labourer and employer by superseding the necessity of using the services of the latter functionary." "Co-operation combines in the same persons the two capacities of labourer and capitalist." Which of these statements gives the more correct and the more instructive idea of the Co-operative Movement? Give reasons for your opinion. (*Cert.*)

4. What are the main obstacles to the spread of co-operative production? Describe any experiment of this kind with which you are acquainted. (*Cert.*)

CHAPTER XXV.

TAXATION.

1.—**Functions of Government.**—The limits within which the activity of the government of a state should be confined is one of the most disputed questions in politics. "On the one hand, impatient reformers, thinking it easier and shorter to get possession of the government than of the intellects and dispositions of the public, are under a constant temptation to stretch the province of government beyond due bounds; while, on the other, mankind have been so much accustomed by their rulers to interference for purposes other than the public good, or under an erroneous conception of what that good requires, and so many rash proposals are made by sincere lovers of improvement, for attempting, by compulsory regulation, the attainment of objects which can only be effectually or only usefully compassed by opinion and discussion, that there has grown up a spirit of resistance *in limine* to the interference of government, merely as such, and a disposition to restrict its sphere of action within the narrowest bounds" (J. S. Mill). These two tendencies may be called respectively Socialistic and Individualistic. Mill divides the functions of government into—

(*a*) Necessary, those "which are either inseparable from the idea of a government, or are exercised habitually and without objection by all governments";

(*b*) Optional, as to which "the expediency of its exercising them does not amount to necessity, and is a subject on which diversity of opinion does or may exist."

Examples of the necessary functions of government are—

(1) The raising of a revenue to support its expenses;

(2) The framing of laws on the two great subjects of property and contracts;

(3) Judicature and police.

From among the optional functions of government, Mill selects for notice, as being "interferences grounded on erroneous theories": Protection, Usury Laws, Attempts to regulate the prices of commodities, Monopolies, Combination Laws, and Restraints on Opinion or on its publication. As to other cases of government interference, Mill holds that *laisser-faire*, that is, freedom to the individual to do as he pleases, is the general rule, but liable to large exceptions, such as—

(1) Cases in which the consumer is not a competent judge of the commodity. To this head he refers the duty of government to provide for the education of the people.

(2) Cases in which persons exercise power over others.

(3) Cases in which public intervention may be necessary to give effect to the wishes of the persons interested. As an example, we may refer to the regulation of hours of labour (xxix., 8).

(4) Cases where private agency would really be more suitable, but is not forthcoming.

2.—**Government Revenue.**—The chief source of government revenue is taxation, *i.e.*, the "compulsory contribution of the wealth of a person or body of persons for the service of the public powers." The wealth which is so contributed is in modern times chiefly in the form of money, but governments usually compel more or less work to be done for them directly (conscription, jury-service, &c.), or goods to be directly supplied (billeting, "purveyance," &c.). Further, there is more or less trading carried on by the State: in many countries the railways belong to the State, and in our own, tramways, water- and gas-works, &c., are owned by local governing bodies, and the post-office by the central government. Considered merely as business enterprises, government trading seems on the whole a failure. It obstructs progress, it rules its agents tyrannically, and is inefficient.

Lastly, States derive some portion of their revenue from Crown lands. These, also, are usually managed uneconomically.

3.—**Taxation.**—The discussion of the principles of taxation belongs to political economy regarded as an art (ii., 1), and, therefore, other than purely economic considerations have to be also taken into account. It is by economic reasoning that we trace the effect of particular taxes on production and distribution, and discuss the fiscal policy that will probably give the greatest revenue to the State at the least cost to the tax-payers. But notions of justice must guide the politician in allotting the burden of taxation among the various classes of citizens, and the distribution of political power must also be kept in mind. ("No taxation without representation.")

Taxation was deeply studied in the 18th century. It was at that time regarded in England, as it still is in many foreign countries, as a means, not only of raising a revenue, but also as a means of impoverishing foreign nations, relatively if not absolutely. Another object of taxation, proposed by Socialists, is the equalisation of incomes.

In imposing taxation, a great variety of questions incidentally present themselves. Is it better to have dear necessaries and cheap comforts, or *vice versâ?* (xxiii., 9). If luxuries only are taxed, a parsimonious man may escape altogether. Taxation may discourage habits which are morally undesirable, *e.g.*, drinking, smoking, &c. But is it advisable that the government should undertake the supervision of private morality or prudence? Mill was strongly in favour of taxing ostentation. He also advocated taxation of the "unearned increment" (xx., 12). The benefit of taking off a tax is never equal to the evil of putting it on. Taxation may effect an economic gain, if the government gather up money that would otherwise be wasted, and apply it profitably. This may be the result of taxing incomes, and applying the proceeds to the reduction of the national debt; since the income surrendered to the tax-gatherer might have been spent in unprofitable indulgence, whereas, the stockholder, who receives payment of his capital, will probably seek to re-invest it productively.

4.—**Historical Sketch.**—Before proceeding to the principles which have been established as to taxation, we will briefly review the history of the English revenues.

In Roman times, taxes were paid in kind, and assessed on cattle (*scriptura*, the number of cattle being inscribed on the tax-gatherer's roll) and on men (*capitatio humana*, a poll-tax).

The Saxon Kings derived their ordinary revenue from Crown lands, law fines, and a hearth-tax (fumage). In time of danger, the Witenagemot imposed shipgeld on the counties, for the provision of ships, and under similar circumstances, the Witan, from 991 to 1051, granted Danegeld—a direct tax on land to the Crown.

From these extraordinary grants sprang English political liberty, since the Witan maintained that all revenue enjoyed by the King over and above the ordinary income of the Crown must be granted by them, the political ancestors of the British Parliament.

Under the Normans, personal services were demanded, and a land-tax levied on the hide (about 100 acres). These developed, under the Plantagenets, into a money-payment (scutage) in lieu of military service, and a land-tax on the carucate (a season's ploughing of the *caruca*, a team of eight oxen). Scutage and carucage were replaced by the tallage, a tax on rents and effects. Edward I. having levied tallage without authority, the statute "*De tallagio non concedendo*," in 1297, expressly made the consent of all freemen necessary to the legality of the tax.

The tallage was levied as a fraction (varying with the King's requirements) of moveable property. This led to disputes as

to the basis of assessment of such property, which were settled in 1334 by an agreement that a tenth on tenants of the demesne, and a fifteenth on others, should mean a definite fixed sum—£39,000 in all. Thus a tenth and a fifteenth, or so many tenths and fifteenths, meant a tax of a definite amount on each locality. Some localities decayed, and were excused payment; in the others it was easier to assess each man's contribution by reference to his land than by reference to his moveable property. Thus tenths and fifteenths gradually became a tax on real property, and reduced in amount.

In 1377 a poll-tax of 4d. ("the tallage of groats") was imposed. Poll-taxes have been disused since 1698.

During the first half of the 15th century there was a graduated income-tax, which, in the following century, was elaborated into the Tudor Subsidy. The full subsidy ultimately became 2/8 in the £ on moveables, and 4/- in the £ on profit of land, only the one or the other to be charged on any person, not both.

The fifteenth and tenth and the subsidy gave way, under the Commonwealth, to monthly assessments of a fixed sum on each locality, and this, after the Revolution, was replaced by the modern land-tax, which was imposed, at 4/- in the £, in 1692. The last of the oppressive burdens on land, introduced by the feudal system, and now obsolete, were abolished at the Restoration, and, in exchange, £100,000 a year granted to the Crown. The landed influence, however, succeeded in placing this burden, not on the land which was relieved from its feudal obligations, but on the excise. The land-tax varied in amount; in 1732 it was as low as 1/- in the £. Since 1798, landowners have been permitted to redeem the land-tax by making a capital payment.

To return from the land-tax, we find that Edward IV. exacted 'benevolences" from wealthy persons. The practice was 'damned and annulled for ever" in the first year of Richard III., but was nevertheless revived by the Tudors. Its final suppression by the Petition of Right, in 1628, led to the financial distress which gave rise to the demand of ship-money, 1634.

The origin of the Customs is unknown. They were duties paid to the Crown on imports and exports by merchants, who at first were usually foreigners, for privileges and protection. Magna Carta condemns "*mala tolta*," unjust tolls, but

reserves "*rectas et antiquas consuetudines*." The term "ancient" or "great" customs is applied to the rates of 1275, the "new" or "small" customs were paid under agreement made by foreign merchants with Edward I., in 1302. In the following year an unsuccessful attempt was made to extend these customs to native merchants.

Pym has been called the "father of the excise," a system of taxes on commodities of home production, introduced under the Commonwealth and at the sword's point, for such taxes were regarded by Englishmen as a badge of slavery.

Important fiscal changes took place at the Revolution. The revenues of the State now became recognised as those of the Government, no longer of the King. The Commons required estimates of proposed expenditure to be laid before them, and "appropriated" their grants to specific purposes. Under the Stuarts, the debts of the Crown were secured on revenues which were under the sole control of the Crown during the King's life; under William III. the national debt was secured on moneys which were under the control of Parliament. Charles Montague, William's great finance minister, supported the Bank of England project, invented Exchequer bills, reformed the currency, and invented fresh taxes (stamp duties were first imposed in this reign). It was said of him "he has never wanted and never will want an expedient." He is regarded as the father of modern finance, and the first of the five great British financiers (Montague, Walpole, Pitt, Peel, Gladstone).

Sir Robert Walpole "found our tariff the worst in the world, and left it the best." He encouraged shipping by repealing duties on American timber and hemp; gave drawback (a return of duty paid on import) on exported silk; reduced duties on spices, &c.; repealed such export duties on British manufactures as still remained; and introduced the warehousing system, of allowing imported dutiable goods to be warehoused, and pay no duty until withdrawn for home consumption. By this latter invention, goods imported for re-exportation pay no duty at all, while those imported for home consumption do not pay duty until the latest possible moment. Wines, *e.g.*, sometimes lie for years "in bond," and their consumers are spared the additional cost which would be occasioned if import duty had to be paid at the commencement, instead of the end, of the time. During this

period the term "subsidy" was used for an addition of 5 p.c. to the Customs. Thus the "fifth subsidy," about the middle of the 18th century, raised the customs from about 20 to about 25 p.c.

The fatal taxation of the American colonies was due to inability to devise fresh taxation at home. Taxation of colonies was no new thing, however, and some such taxes were not abolished until 1846.

Pitt's finance was less successful during, than it had been before, the great war. After the peace of 1815, Parliament reduced the revenue by remitting unpopular taxation, yet did nothing to liberate trade from its fetters and so promote its activity. In 1822 a reduction in the rate of taxation on certain articles, notably silk, was found to stimulate trade, and proved that a reduction of duties, by increasing consumption and diminishing smuggling, not infrequently leads to an augmented revenue. The principle of Free Trade was thus recognised, but not carried far at that time.

An Income Tax of 2/- in the £, on Great Britain, had been imposed by Pitt, in 1798 as a war measure, and ceased with the war. In 1842, Sir Robert Peel, finding that taxes on commodities were inadequate for the necessities of the government, and yet could not be increased, revived the Income Tax, and reduced indirect taxation. In 1845 he carried his reform further by abolishing all export duties, and more than half the remaining import duties. In 1846 the protective corn duty was removed, and Free Trade expressly adopted. Mr. Gladstone's budgets of 1853 and 1860 completed the change. The old and the new systems may be thus compared: "Under the former, taxation was avowedly imposed for purposes, not of revenue, but of protection; it was distributed over every possible object, and collected in every stage of manufacture. Under the latter, it is uniformly resorted to for revenue alone; it is confined to the fewest possible articles, and collected on the finished commodity, and not on the raw material. Under the former, the direct taxation of property and income was as far as possible avoided; under the latter, it has become the leading feature of every Budget. Under the former, commodities in general use—like soap, candles, leather, glass, bricks, and paper—were heavily taxed; under the latter they have been entirely free. Under the former a pound of tea paid a duty almost as heavy as a gallon of whiskey. Under the latter the tax on spirits is more than twenty times as heavy as the tax on tea; and it has become almost an axiom of financiers to except alcoholic drinks from the general rule, and to raise from them the maximum revenue, which they are capable of producing.

"The result of these reforms has been very striking. When Sir Robert Peel commenced his revision of the tariff in 1842 some 1,200 different articles were enumerated on the list, and the customs revenue produced some £22,500,000 a year. The customs revenue is now practically derived from five articles, and its yield still amounts to about £20,000,000. In 1842 the whole of the revenue amounted to only £48,000,000; of recent years it has occasionally exceeded £90,000,000" (*Edinburgh Review*, July, 1888).

The same difficulties which in bygone times threw the tallage, the subsidy, and the assessment upon land, have in recent times thrown local taxation on land. The difficulty has been met by subsidies to local authorities out of Imperial revenue, and more recently by surrendering certain Imperial taxes to local authorities.

5.—**Canons of Taxation.**—The fundamental principles of taxation are best expressed in the following four "classical" maxims of Adam Smith:—

"1. The subjects of every State ought to contribute to the support of the government, as nearly as possible, in proportion to their respective abilities: that is, in proportion to the revenue which they respectively enjoy under the protection of the State. In the observation or neglect of this maxim consists what is called the *equality* or inequality of taxation.

"2. The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax-gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort by the terror of such aggravation some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even when they are neither insolent nor corrupt. The *certainty* of what each individual ought to pay is, in taxation, a matter of so great importance, that a

very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.

"3. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be *convenient* for the contributor to pay it. A tax upon the rent of land or of houses, payable at the same term at which such rents are usually paid, is levied at a time when it is most likely to be convenient for the contributor to pay; or when he is most likely to have wherewithal to pay. Taxes upon such consumable goods as are articles of luxury are all finally paid by the consumer, and generally in a manner that is very convenient to him. He pays them by little and little, as he has occasion to buy the goods. As he is at liberty, too, either to buy or not to buy, as he pleases, it must be his own fault if he ever suffers any considerable inconvenience from such taxes.

"4. Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the State."

This is called *economy* in taxation.

6.—**Equality.**—Differences of opinion occur as to what constitutes equality of taxation. Adam Smith considered that equality consisted in proportioning taxation to income. J. S. Mill said that "equality of taxation, as a maxim of politics, means equality of sacrifice." There is a greater sacrifice involved in giving up a quarter of an annual income of £100 than in giving up a quarter of an annual income of £1,000. Fawcett said that any particular tax must fall unfairly on some persons. The aim, therefore, of the legislator should be to compensate such inequalities as well as he can. English taxes on commodities fall with undue weight on the poor; the Income Tax falls with undue weight on the rich, and thus some sort of compensation is effected.

7.—**Certainty.**—Taxes on commodities must either be *ad valorem* (proportioned to value) or *specific* (proportioned to quantity). There is some uncertainty attached to either kind. The specific tax takes no account of quality, and its burden will vary if the value of the commodity should vary. *Ad valorem* duties are objected to because—

(1) It is difficult to correctly ascertain the value of the goods.

(2) There is an opening for fraud.

(3) Trade is delayed and hindered.

A plan sometimes adopted, where there are *ad valorem* duties, is to accept the importer's assessment of value, the Government reserving the right to buy at 5 p.c. below such declared value. No *ad valorem* duties are imposed by the present English system. In Eastern countries the amount of the tax is not infrequently left to be determined by the collector.

8.—**Convenience.**—"Bonded warehouses" were introduced by Sir Robert Walpole, at the suggestion of Adam Smith, but they were not established on a sufficiently wide basis until 1848.

The principle is to tax goods as shortly as possible before they are consumed. If the producer has to pay the tax beforehand, the price to the consumer must be increased, not only by the tax, but also by the interest on it.

The effect of the payment of taxes upon the banking system of the country has to be considered. It may not be expedient to make a large number of taxes payable at the same time. Taxes on commodities may be raised by licence; the objection to the method is the lump payment; in its favour is economy in collection. A licence for drinking tea has been employed in Holland. Part of the English taxation on the use of intoxicants is in the form of licences for premises where such articles are sold.

9.—**Economy.**—The maxim of economy may be infringed in several ways:—

(1) The collection of the tax may require a great number of officers and expensive machinery.

About the end of the 16th century, in France, out of 150 million livres paid by the people, only 30 millions reached the Treasury, the rest being absorbed by the farmers of the revenue. At the time of the French Revolution the cost of collection was $10\frac{3}{4}$ p.c., and a quarter of a million persons were employed in the service.

In the United States, during the Civil War, some taxes cost 50 p.c. to collect. The same figure has been given in recent years as the cost in Turkey.

The English Revenue costs about 4 p.c. for collection. Income Tax costs $1\frac{1}{2}$ p.c.; the Customs about 6 p.c., which

includes the expense of the Coastguard, about 2 p.c. Stamp duties may be collected at an expense of less than 1 p.c.

2) Industry may be diverted from a more to a less productive employment. Most taxes on commodities interfere with trade. The amount of the tax has to be advanced some time before the commodity reaches the consumer, who is intended to ultimately pay the tax, and he therefore has to pay interest on that amount. On the other hand, it may be said the State benefits by getting the amount of the tax earlier than it otherwise would. But the State only saves interest at the rate of 3 p.c., while the consumer has to pay interest and profit—say 10 p.c.

(3) Evasions may be encouraged. In Ireland, at the end of the 18th century, the collection of Customs and Excise cost from 8 to 18 p.c., and there was a great deal of smuggling.

(4) The taxpayer may be subjected to unnecessary trouble, vexation, and oppression at the hands of the tax-gatherer. In Bulgaria, half the harvest has been lost by rotting on the ground, where it had to be left until inspected by the tax-collector.

10.—**Direct and Indirect Taxation.**—"A direct tax is one which is demanded from the very persons who it is intended or desired should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another: such as the excise or customs." Direct taxes cost less for collection than indirect, and it is perhaps easier to trace their ultimate incidence. It is also desirable that each citizen should know as exactly as possible the amount of his contribution to national expenditure. But, owing to weaknesses of human nature, it sometimes appears to be a positive advantage of indirect taxation that it obscures such knowledge.

11.—**Incidence.**—Some of the most purely scientific questions in the theory of taxation arise in the course of the inquiry into the ultimate incidence of indirect taxation; the "shifting," or "diffusion," or "repercussion" as it is called, of taxation.

The taxation of a commodity increases its expense of production, and therefore tends to raise its price. The rising of price will diminish demand. The effect of the diminution of

demand will depend on the conditions under which the commodity is produced—whether of constant, diminishing, or increasing return.

(1) If the commodity follows the law of constant return, supply will accommodate itself to demand, and price will be raised by the amount of the tax.

(2) If the commodity follows the law of diminishing return, the diminished demand can be satisfied at a reduced expense of production (exclusive of the tax). Price, therefore, will not rise to the full extent of the tax.

If an export duty were imposed on coal, the price of coal in this country would probably fall.

(3) If the commodity follows the law of increasing return, the diminished demand will require an increased expense of production (exclusive of the tax). Here, therefore, price will rise by more than the amount of the tax.

When cards were taxed 2/- a pack, a pack sold for 5/-. When taxed at 1/-, it sold for 2/6. (The fact that price and tax fell in the same ratio, *viz.*, to $\frac{1}{2}$, is merely a coincidence. The point of the illustration is that the pack, exclusive of tax, was sold for 1/6 under the lower tax, for 3/- under the higher).

When salt was taxed 30/- per cwt., a cwt. sold for 40/-. When the duty was abolished, a cwt. could be had for 3/6.

We assume, as usual, that there is perfect competition, and we neglect transient consequences. *E.g.*, if a tax on tea is suddenly removed, merchants who hold stocks will not be able to recoup themselves entirely for their payment of the tax, inasmuch as new importations will be made of untaxed tea, and the old stocks will have to be sold at the same prices as the new.

12.—**Elasticity.**—When an increase in the rate of a tax produces an increase in its yield, the tax is said to be "elastic."

There are limits to the elasticity of every tax; in every case there is a point such that if the rate be raised beyond it, the yield will not increase.

(1) The higher the rate, in the case of taxes on commodities, the greater the profit of smuggling. This was one of the great obstacles to the success of the Mercantile System. Smuggling was not condemned by public opinion, and was covertly engaged in as a regular business by men of high social standing. In the United States, in recent times, high import duties have been supported by public opinion.

(2) Oppressive taxation gives rise to evasion and bad faith.

(3) Raising a tax increases the price of the article, and diminishes the demand for it. The yield may, therefore, be less at a higher rate than it was at a lower; and conversely, reducing the rate of a tax may increase its yield. It was the exhaustion of the elasticity of taxes on commodities that led to the Income tax of 1842, and the subsequent adoption of Free Trade.

In 1745 the duty on tea was reduced from 4/- to 2/- per lb. The tax had yielded £175,000 per annum on the average of five years before the change; on the average of five years afterwards, it yielded £318,000.

In 1804 the sugar duty was raised by 20 p.c., and the revenue from it fell by 8 p.c.

The tax on hair powder at a guinea a year gave £210,000 per annum during part of the 18th century. The rate was raised, but the yield diminished. The tax was subsequently repealed.

13.—**The Income Tax.**—This is a direct tax levied in proportion to income. Its advantages are that it is cheaply collected, its yield is easily calculable (about a million and a half for every penny in the £), it can be suddenly increased without disturbance to trade. On the other hand, it is said to be "as unjust in practice as it is just in theory." The practical difficulty of collection stands in the way of imposing it upon the working-classes; and, in other cases, either its assessment must be left to the honour of the tax-payer, or its administration must be inquisitorial. Some 40 or 50 millions of income from foreign investments seem to escape the tax.

In applying the maxim of equality to the income tax, there are two points to notice—

(1) The amount,

(2) The source, of the income.

As to amount, an obviously unequal sacrifice is involved in demanding the same proportion of small and of large incomes. As to source: incomes derived from land are usually permanent, and often are likely to increase; from capital are permanent, though likely to slowly decrease; from profit, may be regarded as comparatively permanent, in respect of goodwill; but incomes derived from personal efforts, whether in business, arts, or professions, are temporary. Fawcett argued that there is no injustice in taxing permanent and

temporary incomes alike, since the permanent income bears the tax in perpetuity, the temporary income only while it is in fact enjoyed. Mill proposed to exempt ¼ of a terminable income from taxation. The principle of equality seems to require—

(1) Exemption from taxation of the cost of subsistence, and the deduction of an equivalent amount from every larger income before taxing the remainder.

(2) A differential rate varying according to the source of the income.

(3) A progressive rate varying according to the amount of the income.

The adoption of such graduation is, however, attended with grave political dangers. The most numerous voters are necessarily the poorest, and there is great risk of injustice.

In the English system, no difference of treatment has been accorded to incomes arising from different sources, but the tax is graduated according to amount of income.

From 1853 to 1861, incomes under £100 were exempt; incomes from £100 to £150 paid rates varying at different times from 5d. to 11½d. in the £, while incomes over £150 paid rates varying at different times from 7d. to 1/4 (during Crimean War) in the £.

Since 1861 a similar aim has been pursued by exempting incomes under a certain amount (£160 at present), and making a deduction (which has varied from £60 to £160, the present figure) from incomes not exceeding an amount which has varied from £200 to £400, the present figure.

Mill proposed to deduct £60 from all incomes before taxing, without other abatement.

14.—**Present System of English Taxation.**—In round numbers, the national income of 119 millions in 1898-9 was derived as to 29 millions from the Excise (chiefly on Spirits and Beer); as to 21 millions from Customs (Spirits 4 millions, Tobacco 11 millions, Wine 1½ millions, Tea 4 millions, Beer, Chicory, Cocoa, Coffee, and Dried Fruits); as to 13 millions from Income Tax; as to 5 millions Property Taxes; as to 11 millions from Death Duties; as to 16 millions from Posts and Telegraphs; as to 7½ millions from Stamps (chiefly imposed on documents used in business).

Land Tax yielded £800,000; Crown Lands (net) £430,000. Posts and Telegraphs cost 11 millions.

Over 9½ millions were paid out of Imperial Taxation to local taxation accounts.

15.—**Loans.**—Extraordinary national expenditure is now usually met by means of loans. *E.g.*, the expenses of the war in South Africa have partly been defrayed by the issue, in March, 1900, of a National War Loan of 30 millions at 2¾ p.c.; price of issue was 98½, and the stock is redeemable at par in 1910.

Dr. Chalmers was of opinion that extraordinary unproductive expenditure should be raised by taxation not by way of loan. This view was based on the wage fund theory. It was assumed that if capitalists advance money to the government by way of loan, that amount of capital is withdrawn from the wage-fund (xxiii., 8); in consequence, labourers suffer an equivalent reduction in their aggregate wages. No worse could happen to them if the amount of the loan were raised at once by taxation, whereas in this case there would be an end of the matter, while in the former there is the burden of interest and capital still remaining.

Since the abandonment of the wage fund theory, and the great increase in disposable capital, the foundation of Dr. Chalmers's argument has vanished.

Capital is now so abundant that the absorption of part of it by a national loan of comparatively moderate amount inflicts no appreciable injury on trade. The sacrifices involved in war are incurred for the benefit of posterity as well as of the present generation, and it seems just that posterity should help to pay.

The fall in the rate of interest and the increasing growth of capital which seem to naturally accompany economic progress (xxi., 3), make the burden of a national debt grow lighter.

16.—**The National Debt.**—In 1667 an act was passed to encourage the advance of money to the Crown on the credit of the Exchequer, and London bankers lent very considerable sums on that security. In 1672 the King closed the Exchequer (xv., 1), paying interest, however, on the money so appropriated, at the rate of 6 p.c. up to 1682. From that time the Bankers' Debt was ignored, until 1705, when it was recognised as part of the national debt, but at only half its capital value and with forfeiture of arrears of interest. The first regular loan to William III. was that of 1694 (xv., 6). At the accession of Anne the national debt stood at 13 millions; at that of George III. it amounted to over 100 millions. The American War largely increased it, and the French War still more, and it touched its highest point, 900 millions, in 1816. Since then it has been reduced, and now stands at about 600 millions. Mr. Goschen's National Debt (Conversion) Act, 1888, provided for a reduction of interest from 3 p.c. to 2¾, and ultimately to 2½ (xvi., 6), an operation which effected a saving to the country of £1,400,000 a year from 1889 to 1903, and after that of £2,800,000 a year.

The debt is being steadily reduced by means of Terminable Annuities. The Treasury is empowered to grant a temporary Annuity in exchange for stock (*i.e.*, a permanent annuity). Thus Alpha transfers to the Treasury £1,000 of 2¾ p.c. stock on which he is receiving £27 10s. 0d. a year; the Treasury in return undertakes to pay Alpha £55 a year for about 20 years. The Treasury cancels the £1,000 stock and thus reduces Consols by that amount, but during 20 years it has to make larger annual payments than if it had not effected the transaction. At the end of the 20 years the redemption of the £1000 Consols has been effected, and the annual amount of the terminable annuity is available for other purposes.

Every year a fixed sum (at present 23 millions) is set apart for the service of the Debt. Part goes in payment of ordinary dividends on Consols, part in payment of terminable annuities, the balance is called the New Sinking Fund, and is also devoted to diminishing the capital debt.

17.—**Local Taxation.**—Beside the taxation imposed by the central government, vast sums are raised by local governing bodies. In the year 1896-7, in England, the income of such bodies (excluding loans, contributions from imperial taxation, and revenue from property and businesses, such as gas and water-works) was nearly 44 millions.

Loans are also contracted by these bodies, and amounted in the year 1896-7 to 250 millions, having increased from 186 millions in 1886-7, and 106 millions in 1876-7. All local loans are subject to repayment at a fixed period; about ⅔ of their amount is remunerative, being sunk in gas and water works, &c.

18.—**Proposals.**—The following proposals were made by J. S. Mill, by way of improvement of the English fiscal system—

(1) Tax the "unearned increment" of "economic rent";

(2) Impose a house-tax

(*a*) On houses, to be paid by the occupiers;

(*b*) On ground rents, to be paid by the landlord. This latter proposal resembles the tax on unearned increment. A tax on houses seems one of the best that can be devised, since expenditure on house-accommodation is a fair test of general expenditure, and expenditure, rather than property, is the true basis of taxation. But in this case, as in that of luxuries, it would be possible to evade taxation, by living in a house beneath one's station. And houses in England are, even as it is, far too poorly and meanly built as a rule.

3) Tax legacies and inheritances more heavily. The State may fairly prescribe the limits within which a man shall be permitted to enjoy the property of a deceased citizen. This suggestion has been adopted in the Finance Act, 1894, under which an estate worth £101 to £500 pays 1 p.c. on the owner's death, and the rate is graduated up to 8 p.c. on an estate worth £1,000,000 or more. Further Death Duties are charged, varying with the relationship of the beneficiary to the deceased: they rise to 10 p.c. where distant relatives or non-relatives succeed.

(4) Tax ostentation. This will probably not produce much.

It is thought that the basis of our taxation is too narrow, and additional subjects have been proposed, *e.g.*, advertisements, matches, photographs, sugar.

QUESTIONS AND NOTES.

1. For a full discussion of the subjects of this chapter, see MILL's *Principles of Political Economy*, Book V., especially chapters 2 to 7, and for information up-to-date, see the current volume of Whitaker's Almanac or Hazell's Annual, articles "National Income and Expenditure," "National Debt," "Income Tax Rates," &c.

2. Distinguish direct and indirect taxation. What taxes are levied indirectly at the present time in England on necessaries and on luxuries? (*Cert.*)

Mill's definition of "direct" taxation is given in the text. Sometimes "direct" taxes are defined as those imposed on income and property, and "indirect" as those imposed on "commodities." T. Raleigh in his *Elementary Politics* defines "luxury" as "pleasures which do not refine, but enervate and degrade, those who enjoy them." This would bring all intoxicants into the class of luxuries. Condillac's definition (viii., Notes 1) would exclude beer, at any rate, from luxuries.

3. What is "direct" taxation, and what are the arguments for and against it? Do you regard the conscription in France, Germany, and other countries as a form of direct taxation? Give reasons for your answer. (*Cert.*)

4. Write notes of a lesson on the national debt, under the heads of origin and history, amount and annual charge, means employed for reducing it, use as a safe form of investment. (*Cert.*)

5. What are the arguments for and against a graduated system of direct taxation? Show what has been done in the way of graduation by the Budget of the present year. (*Cert.*)

6. State some rules or canons of taxation with which you are acquainted, and apply them in commenting on (*a*) indirect taxes on necessaries, (*b*) indirect taxes on luxuries, (*c*) the income tax. (*Cert.*)

7. Explain the terms "direct taxation"; "indirect taxation"; "the ultimate incidence of taxation"; "progressive taxation"; "income tax"; "the Excise"; "Customs Duties"; "public debts"; "local indebtedness," with reference to the present state of England. (*Cert.*)

8. What do you understand by the incidence of a tax? Trace the incidence of the following taxes:—(*a*) the tobacco duty, (*b*) the death duties, (*c*) a tax on cycles. (*Cert.*)

9. How do the poorer classes at present contribute to the national exchequer? Do you consider that the burden of taxation is, on the whole, fairly distributed? (*Cert.*)

10. Consider the arguments for and against the principle of graduated taxation. Point out some of the practical difficulties of this kind of taxation, with special reference to the proposal to apply it to the English income tax. (*B.I., Fin.*)

11. Explain the terms "shifting" and "incidence" in reference to taxation, and state the chief conditions that should be taken into account in estimating the incidence of a given tax. (*A.S. of Taxes.*)

12. Institute a comparison between direct and indirect taxation in respect of the conformity of each class to the recognised canons of taxation. State shortly your own view as to the ground of distinction between "direct" and "indirect" taxes. (*A.S. of Taxes.*)

13. What do you understand by "equality of taxation"? In what various ways have economic writers suggested that "equality of taxation" may be best secured, and how far is it possible in a practical system of taxation to carry such suggestions into effect? (*A.S. of Taxes.*)

CHAPTER XXVI.

FREE TRADE.

1.—**Gain from Foreign Trade.**—The nature of the advantages derived by a country from foreign trade is shown in chap. xviii. It consists, in effect, in rendering the country's

industry more productive, and is quite accurately expressed by saying that international trade extends to the greater community formed by the inter-trading states the benefits which, within itself, any one state derives from division of labour.

A country can never be economically a loser by foreign trade. It sometimes seems to be thought that if a particular country is ill-suited for the production of wealth, its inhabitants may make a decent living by their own exertions, if left to themselves, but that if foreign trade is permitted, foreign goods, made under more favourable circumstances than prevail in the country in question, will under-sell home-made goods, the inhabitants will fall out of work, and the country will be impoverished. Some such view is implied in remarks to the effect that it is useless to have cheap imported goods if we cannot earn any money wherewith to buy them. That it is fallacious is evident on considering—

(1) No goods can be imported without goods to an equal value being exported (xviii., 7);

(2) A country exports goods which it produces at a relative advantage, and imports those which it could only produce at a relative disadvantage (xviii., 2).

There may be ulterior effects which deserve consideration. The imports may be articles of injurious indulgence, such as opium or alcoholic liquors. But considerations of this kind belong as much to internal as to foreign trade.

2.—**Effects on Distribution.**—Foreign trade being essentially the substitution of more for less efficient methods of production, no doubt presses occasionally on particular trades. It tends to prevent monopoly in the imported commodities. It tends to bring all producers under the bracing effects of competition and bargaining, and, therefore, individuals or classes may often be injured by it apparently and temporarily, rarely really or permanently, while the community as a whole is always benefited by it economically.

Where raw materials are imported, rents may suffer, and landowners will be displeased (xx., 8). Since 1877 there has been an actual fall in the total rental of agricultural land in the United Kingdom.

On the other hand, if a foreign market is found for raw materials, particularly foodstuffs, output may be increased under conditions of diminishing return, and rents may rise. But even here there is an economic gain on the whole, since

the exports are produced at a relative advantage, and if this relative advantage should be lost by reason of diminishing returns, the export will cease of itself.

Productive efficiency being increased on the whole, industry has a greater aggregate reward, which will probably be distributed more in proportion to relative importance of services rendered than the smaller aggregate reward gained under a less efficient organisation.

3.—**Other Views.**—In early times the advantages of foreign trade were differently stated. Gold and silver were regarded as the principal, if not the only forms of wealth, and foreign trade was considered to benefit a country by bringing in useful commodities which could not be produced at home, and especially the precious metals.

From the 14th to the 17th centuries many measures were adopted in England with the object of encouraging the importation and discouraging the exportation of gold and silver. At the same time, and partly with that object and partly to obtain a revenue for the King, various taxes were laid on importation and exportation of other commodities.

This Bullionist or Balance of Bargains System was, soon after the discovery of the New World, replaced by the doctrine of the balance of Trade. The direct attempt to bring in gold and silver was abandoned, and a more circuitous method recommended. It was argued that if a country, on the whole, exports a greater value of commodities than it imports, there will result a balance of gold or silver due to it from other countries; the art, therefore, of enriching a nation consists in so regulating its trade as that its exports shall be of greater value than its imports. Such a condition was called a favourable balance of trade, while the balance was said to be against a country when the value of its imports exceeded that of its exports, and an export of gold or silver, therefore, became necessary. The principal devices adopted in pursuance of this policy were Protective Duties, Bounties, Colonial Monopolies, and Treaties of Commerce.

4.—**Protective Duties.**—The imposition of a duty on the importation of a commodity—

(1) Adds to the revenue of the State;

(2) Tends to check importation.

This latter effect was deemed desirable by the Mercantilists.

They had not grasped the truth that the importation of a commodity necessarily implies that the importing country produces, instead of that commodity, some other in which it has a relative advantage. No restraint was placed by the Mercantilists on the importation of such commodities as were supposed to conduce, by their importation, to an export of greater value, while, in some cases, a tax was imposed on exportation, generally in the case of raw materials, in order to favour the exportation of the same substance in a manufactured form, and, therefore, at a higher price.

5.—**A Bounty** is a payment made by the Government to an exporter or importer of a specified commodity, in proportion to the quantity exported or imported. It has been called a "negative tax," since it reduces the price of the commodity, instead of raising it. It tends to increase the amount of foreign trade, the gain from which will be divided according to conditions of demand (xviii., 4). A bounty on exportation generally benefits chiefly the importing country, at the expense of the country giving the bounty. It works counter to the great principle of Free Trade, by inducing an export of a commodity in the production of which the exporting country has *not* a relative advantage. It is a premium on misdirection of effort. Countries which import a bounty-fed commodity may impose an import duty equivalent to the bounty as a "countervailing" duty, and thus neutralise the mischief.

6.—**Colonial Monopoly.**—During the 17th and 18th centuries, it was the practice of those European nations who had colonies to insist on a more or less rigid exclusion of all foreigners from the trade between a colony and the mother-country.

7.—**Treaties of Commerce.**—During the prevalence of the Mercantile System it was a prime object of diplomacy to enter into treaties by which a foreign nation bound itself to admit commodities of the other contracting nation on favourable terms. The treaty usually assumed the form of a bargain, one of the clauses often being to the effect that each contracting nation mutually would give to the other as favourable terms as it should thereafter grant to any third nation. Such a clause is called the "most favoured nation" clause.

8.—**Free Trade.**—In 1776 Adam Smith's *Wealth of Nations* attacked the Mercantile system and its attempted "protection" of trade. The steps by which England abandoned protective duties are indicated in chap. xxv.

Since 1846 the policy of England has been to leave foreign trade to follow its course, unhampered by state interference. Import duties are imposed on a few articles, but solely for the purpose of raising revenue, and with no view to favouring any class of traders. Many of the taxed imports are such as cannot be produced in this country, and, as to the others, there is a "countervailing" excise corresponding to the customs, so that home producers are placed at an equal disadvantage with importers. Our import duties are, therefore, Revenue, and not Protective, Duties. Note that a Revenue duty is most successful when it is most productive, which will be when trade is most flourishing, whereas a Protective duty is most successful when it is least productive, since its object is to discourage trade.

Even Revenue taxation of commodities is an economic evil. It diminishes the enjoyment which might be derived from the taxed article by diminishing its consumption, and where it prevents exchange it prevents the creation of the utility which is the consequence of exchange.

It does not seem necessary to say more in favour of Free Trade than has been already indicated. It stands on the same basis as internal trade; its benefits are of the same nature. It has, however, been advocated on the following grounds:—

(1) Man has a "natural right" to exchange his products. Adam Smith condemned restrictions on trade as being "violations of natural liberty." The notion of "nature," however, is not helpful.

(2) Actual loss and suffering have resulted from Protection, and gain and prosperity from Free trade. But the causes of national prosperity are so complex, that without abstract reasoning we cannot feel any confidence in appeals to experience.

(3) Protection is useful at an early stage of economic development, but at a later, Free Trade is more desirable. No doubt Free Trade is the result of economic progress, but it may be doubted whether Protection was ever economically beneficial.

9.—**Protection.**—England's example in adopting Free Trade has been but little followed by other nations. The Balance of Trade theory has been abandoned, but protective duties are still imposed, their object now being no longer to secure an influx of gold and silver, but to prevent internal producers being undersold by importers. The fallacy of this view has been pointed out above.

10.—**Nursing Industries.**—It is so plain that protective taxation must impoverish the nation imposing it that most of the arguments in its favour are non-economic. Almost the only economic argument for it is the assertion that in certain cases an industry may be really suitable for a country, but cannot be set up in the face of the unchecked competition of foreign countries where it is well established. The English Navigation Acts have been cited as an example of temporary protective legislation, which enabled a strong mercantile marine to be formed. It must be remembered that a powerful navy is essential to the existence of England, and that no sacrifice would be too great as the price of its creation and maintenance. In France, similar legislation has not had similar results. It is too much, therefore, to say that the predominance of English shipping, under present freedom, is due to past protection.

There are few, if any, recorded cases, in which an industry has been founded under the shelter of protection, and has afterwards been able to dispense with such shelter. On the contrary, the tendency is for a protected trade to demand still further protection, while unprotected trades, finding themselves at a disadvantage, demand to be protected also.

Even if an industry be built up by means of Government interference, it is more probable than not that the country would have been better off economically had trade been left to develop freely.

11.—**Non-economic Arguments.**—When it is admitted that protection involves an economic sacrifice, which a country is advised to make on the ground that national well-being is preferable to national wealth, the advocate of protection has to face a very great difficulty. Economic loss is a certain evil; wealth is a necessary condition of national well-being. A statesman is not justified in diminishing his country's productive efficiency, except on the most cogent proof that such diminution is either inevitable or will certainly be followed by more than equivalent gain of some other kind. We may briefly notice the principal arguments usually put forward—

(1) *National defence.* For this purpose, any necessary restrictions must be submitted to.

(2) *The protection of agriculture.* It would raise rents, and diminish the food-supply, neither of which results seem peculiarly desirable.

(3) *The protection of manufactures.* So far as protection in the United States is not dictated by mere prejudice and party- and class-interests, it seems based on the notion that freedom would give over the country entirely to the raising of raw produce, and that this would cause the people to be comparatively uncivilised. This is inconsistent with that affection for "a bold peasantry, their country's pride," which sometimes prompts a demand for protection to agriculture.

12.—**Reciprocity.**—The principle of the commercial treaty reappears in the advocacy of reciprocity, or *Fair Trade*, *i.e.*, the offer of Free Trade to Free Trade States, and Protection to Protectionist States. The suggestion is obviously based on the assumption that protection is economically advantageous, and in any case seems illogical. For either Free Trade is more profitable to the country practising it than Protection, or *vice versa*, and why should England adopt in any particular case that policy which is the less profitable to herself?

There are reasons for thinking that England has benefited relatively by the almost universal adoption of high tariffs by other commercial nations. "Her trade is, indeed, affected by the duties of other countries; but, then, so also is the trade of each of those countries, while she has an advantage when competing with any of the duty-levying nations for the consumption of the products of a third country. The terms of exchange are altered by the operation of the duties, and, in addition to this advantage, she gets the commodities she needs by as much less as the amount of the duty in other nations. In the export trade she has the benefit of her cheaper imports, so far as they are auxiliary to production, which, in a highly-developed system of industry, must be generally an important factor; and she further possesses the

advantage given by the influence of freights, by reason of which, other things being equal, her exports will be preferred to those of the countries which levy high duties"; since, her imports being abundant, a ship which carries her exports to any country will be sure of getting a return-cargo (Bastable, *Theory of International Trade*).

There is some force in the proposal to impose countervailing duties on bounty-fed commodities. If, *e.g.*, France encourages the export of sugar to England by a bounty, it is true that England benefits by the bounty. But is it wise to accept the benefit in the form desired by France? Would it not be better to impose an import duty of amount equal to the bounty? In that case, France would pay tribute to our revenue, and French sugar would compete in our market on its merits. By accepting the bounty in the shape of cheap sugar, we benefit as consumers of sugar, and many of our industries benefit by obtaining one of their materials very cheaply; but meanwhile the West Indies, countries which are naturally better fitted than France for the production of sugar, are undersold, their industry is destroyed, and they are partially ruined. Bounties are a form of that dishonest competition which consists in selling a commodity under cost for a time in order to ruin a competitor, and obtain a monopoly (vi., 8).

Whether an export duty should be imposed on English coal is one of the most difficult questions that can be raised. We need to consider—

1) What deposits of coal exist in other parts of the world. Checking our exports would tend to develop the working of those deposits.

2) What will be the future course of invention. For how long will coal continue to be the life-blood of industry?

3.—**Customs Union of British Empire.**—The proposal has been made that the various parts of the British Empire should practise Free Trade between themselves, but Protection as against other countries. It is thought that by such a policy the British Empire would be enriched, if not absolutely, at least relatively to the rest of the world, and that its solidarity would be promoted. Economically, it must be repeated, even "one-sided" Free Trade is more profitable than Protection, however manipulated. This, however, is not conclusive of the political question.

QUESTIONS AND NOTES.

1. Explain generally how a bad harvest affects the industries of England, and state the chief sources from which a large part of the home supply of bread stuffs is usually obtained. (*Cert.*)

A bad harvest will cause (1) a rise in the price of corn, which involves a reduction in real wages, and depression in all trades, commencing with those producing luxuries. (2) Importation of corn, tending to an adverse exchange and higher discount rate. In both ways a fall of general prices is favoured.

Details of British commerce may be found in the "Statesman's Year Book" and similar publications. In 1899 the United Kingdom imported nearly 200 million cwts. of cereals and flour, the bulk coming from the following countries (in order of quantity of wheat supplied):—United States, Argentina, India, Canada, Australasia, Russia.

2. Point out some of the civilising effects of trade with barbarous nations. Illustrate by the story of Livingstone's life. (*Cert.*)

3. To what causes has been due the great depression in English agriculture of late years? Comment on the proposal to re-impose a duty on corn. (*Cert.*)

4. The price of wheat in England during the autumn of 1894 was lower than it had ever been before. To what causes would you ascribe this? (*Cert.*)

5. Protection by a Customs' Tariff has been considered necessary for the creation of manufactures. Can you show that, if this is true, protection is advisable in the interests of the protected country? (*Cert.*)

6. Briefly explain the terms: Protection, Reciprocity, Free Trade, Treaty of Commerce, Favoured-nation-Clause. (*Cert.*)

7. State briefly some of the arguments for and against free trade. How would you account for the existence of a strong protectionist feeling and policy in a country like the United States? Are treaties of commerce defensible on free trade principles? (*Cert.*)

8. What do you understand by Revenue duties and Protective duties? Examine the probable effects on (*a*) the internal trade, (*b*) the foreign trade of the United States by the re-imposition of heavy protective duties after a period of their being more or less relaxed. (*Cert.*)

9. What are the main arguments for and against Free Trade? Is Free Trade the same as "the open port," of which so much has been recently heard? (*Cert.*)

"Open port" does not refer to Free Trade, but to the seizure by various European powers of ports in China, and to the question whether such ports were to be open to other powers or not, irrespective of the question of duties.

10. Countervailing duties have just been imposed by the Indian Government to meet the bounties on foreign sugar. Explain what this means, and point out any circumstances which distinguish the case of India from that of England. (*Cert.*)

11.—Discuss how far a *general* shortening of the hours of labour in England affects her power of competing in neutral markets.
(*L.C.C.* (*Com. His. & P.E.*), *Sen.*)

12. What different views have been held as to the value to a country of an *export trade?* How does a system of protective tariffs affect the question of exporting? (*B.I., Prel.*)

13. What are, practically, the great arguments in favour of freedom of trade? What have been in recent times the most powerful causes of the prevalence of high tariffs. (*B.I., Prel.; and A.S. of Taxes*).

14. Suppose that a heavy duty were imposed upon the export of coal from this country, and the proceeds applied as a bounty upon the production of iron and steel, what would theoretically be the effects of such a measure, neglecting the cost of its administration?
(*A S. of Taxes*).

15. In what respects does international trade resemble, and in what does it differ, from trade conducted within the limits of a single country? Examine the bearing of these similarities and differences on (*a*) the economic theory of value as applied to international trade; (*b*) the commercial policy of nations. (*A.S. of Taxes.*)

The principal "difference" referred to is the greater force of "industrial" competition within a single country than as between different countries. If we assume perfect industrial competition within a country, then values in that country will very nearly correspond to *cost* of production.

16.—What is meant by Free Trade? When did the principles of Free Trade first begin to be adopted by the English Government?
(*L.C.C., Jun.*)

17. Explain what is meant by Bounties. Give instances of them, and describe their economic effects. (*L.C.C., Jun.*)

18. Examine into the main arguments, (*a*) theoretical, (*b*) practical, which may be urged for and against a Customs Union of the British Empire. (*A.S. of Taxes.*)

CHAPTER XXVII.

BI-METALLISM.

1.—**Bi-metallism** is a particular system of currency. It is that form of "multiple legal tender" (xiv., 2), which consists in freely (not necessarily gratuitously) (xiv., 8) minting two metals, and making each of them legal tender to any amount, at a ratio which is fixed by law. Thus in France from 1803 to 1874, the government coined any quantity that was presented for that purpose of either silver or gold, and debts of any amount were payable in coins of either metal, the relative values of the coins being so fixed that $15\frac{1}{2}$ oz. of silver coins were worth 1 oz. of gold coins.

Since 1874 bi-metallism has fallen out of use, and is now practically non-existent in the world, all the leading commercial countries having in practice adopted gold monometallism. It is argued, however, that if these nations would agree together to maintain a bi-metallic standard, it would be to their

advantage. The alleged benefits to be derived from bi-metallism are briefly—

(1) Greater stability of general prices;

(2) A par of exchange between gold-using and silver-using countries.

This latter argument assumes that certain nations, especially India, are likely for a long time to come to continue to use silver as their medium of exchange, and others, such as England, the United States, &c., are likely to use gold.

The argument in favour of bi-metallism may be given in more detail thus—

(1) The joint production of gold and silver is likely to vary less than the production of either metal alone. Bi-metallism would, therefore, prevent the disastrous results of a silver- or gold-famine. It used to be said that the production of gold was more accidental and spasmodic than that of silver, but this difference has decreased of late years. And the world's output of gold has grown so vastly within the past few years, that one of the greatest arguments in favour of bi-metallism—the fall of prices due to demonetisation of silver and insufficiency of gold to maintain prices—seems to be losing its force.

(2) Facilitation of international trade. But the commercial nations of the world seem determined to adopt gold as their standard, and the recent large supplies from the mines, if maintained, may enable them to do so.

(3) If gold is the standard in some countries, and silver in others, there is, in fact, as to trade between such countries, a bi-metallic system—but it is "unrated," that is, at a fluctuating ratio.

(4) Payments from India to Europe have been disorganised by the fall of the rupee. This coin was worth 2/- before 1874, now it stands at about 1/4. Heavy losses have thus accrued to the Indian Government, which has to make large gold payments in Europe. Indian taxation is imposed in rupees, and, therefore, has had to be increased in order to raise the same amount of gold as formerly.

(5) Agriculture is disorganised. In India, commodities have preserved their rupee-values. Thus the wheat which in 1870 cost 10 rupees, costs 10 rupees still. But whereas 10 rupees were worth 20/- in 1870, they now are worth little more than 13/-. Hence Indian wheat is exported to England,

where it undersells English and American wheat, and thus tends to bring down English general prices.

(6) The fall of prices and consequent depression of trade after 1873 were attributed to the suspension of French bi-metallism.

The following objections have been made to bi-metallism—

(1) It is artificial and impossible. The best answer to this is an historical one. We have seen that, from 1257 to 1664, and again from 1717 to 1816, England practised bi-metallism. But the best example is that of France, where the system was established in 1803 by "la loi du 7 Germinal an xi.," which defined the franc as consisting of 5 grams of silver $\frac{9}{10}$ fine, and the 20-fr. gold piece as 6·451 grams of gold of similar fineness, a ratio of $15\frac{1}{2}$: 1. At that ratio, people preferred gold, and hence ("Gresham's Law") the French currency came to consist principally of *écus* (silver 5 fr. pieces). During the succeeding 70 years, the ratio of gold to silver throughout the world varied but slightly from the French ratio. That ratio being 15·5, the limits of the market rates were 15·15 and 15·83, although during the period in question the relative supply of the two metals varied widely.

About 1850, economists began to be afraid that the then recent discoveries of gold would cause a glut of that metal. Silver was being driven out of circulation.

In 1852,	France	exported	silver	worth	3	million	francs.
,, 1853,	,,	,,	,,	,,	117	,,	,,
,, 1854,	,,	,,	,,	,,	164	,,	,,
,, 1855,	,,	,,	,,	,,	197	,,	,,
,, 1856,	,,	,,	,,	,,	284	,,	,,
,, 1857,	,,	,,	,,	,,	362	,,	,,

Projects were therefore entertained for establishing gold standards, and it was in pursuance of such a project that, in 1865, the Latin Union was formed by a monetary convention made between France, Belgium, Switzerland, and Italy. These countries agreed to issue similar coins, $\frac{9}{10}$ fine, those under 5 fr. in value being subsidiary coins, and only $\frac{835}{1000}$ fine. The issue of such subsidiary coins was to be proportioned to the population of the issuing country.

In 1867 an International Monetary Conference was held for the purpose of establishing an international gold standard, with the object of arresting the rise in prices due to the influx of gold. In 1873, and in pursuance of the same policy, Germany demonetised silver, and adopted a gold standard.

The result of this step was to throw large quantities of silver on the market, and to drive gold out of circulation in the countries of the Latin Union. These countries, not desiring an exclusively silver currency, accordingly suspended bi-metallism by limiting their coinage of silver. We see then that bi-metallism is possible, and has, in fact, been the means of keeping the ratio of silver and gold steady for 70 years.

(2) It might break down. This is true, and, in fact, it *has* broken down, as we have seen. But the larger the number of commercial states that adopt a policy of bi-metallism with the same ratio, the less is the danger of breaking-down.

(3) Certain monometallists have argued that value is determined by cost of production alone, that this is liable to frequent change, and that to fix the relative value of gold and silver by law is to inflict injustice on the creditor, by giving the debtor the option of paying his debt in whichever metal may happen to be the less valuable at the time of payment. It is true as we have seen, that there is, under bi-metallism, a tendency for now one, now the other metal, to disappear from circulation, according to variations in the relative supply and demand.

Bi-metallism, therefore, may result in the use of an inconvenient metal—gold, when silver would be preferred, or *vice versa*. As against this, we can always have token coins for small amounts, and credit-documents for large; for bank-reserves it matters little, in point of convenience, whether we have silver or gold.

With a double standard, then, there is a compensatory or equilibratory action. At any moment the standard of value is *one* of the two metals, and not both; yet the fact that there is an alternative tends to make each vary much less than it would otherwise do.

(4) The Ratio to be adopted is a practical difficulty of great importance. That adopted by the Latin Union—$15\frac{1}{2}$: 1—was the one actually existing at the time the bi-metallic law was passed by the French Revolutionary Government.

In Japan the ratio has been 5 : 1. Anciently in Europe it was 10 : 1; since the abandonment of bi-metallism, it has fallen to 20 and more : 1. At one time, in Arabia, silver was worth more than gold.

Whatever ratio were adopted, and even if all the nations of the earth combined in one agreement, it seems that in time

one of the metals might go out of circulation, leaving the alternative of acquiescing in monometallism or of revising the ratio, with the inevitable injustice and discontent that would attend such a step.

QUESTIONS AND NOTES.

1. Distinguish between Monometallism and Bimetallism. Which obtains in England? Under what regulations have we coins of different metals in use as legal tender? (*Cert.*)

2. Define Bimetallism—Name the principal countries that have been bi-metallic in the present century, and state the effect that the demonetisation of silver had on them. (*L.C.C., Sen.*)

3. Describe the different ways in which two metals may be combined in a currency system, giving actual or hypothetical illustrations. State generally the limits within which an effective double standard is thought to be possible. (*A.S. of Taxes.*)

4. On what grounds (*a*) theoretical, (*b*) practical, has a system of international bimetallism been advocated? What are the chief criticisms which have been made on such a system from the standpoint (*a*) of theory, (*b*) of practice? (*A.S. of Taxes.*)

CHAPTER XXVIII.

SOCIALISM.

1.—The economic doctrines accepted at any particular time and place, depend upon the economic conditions then and there prevalent. We have observed at many points how economic theory has developed *pari passu* with the economic development of society. When we turn to examine schemes of economic and social reform, we have to note that they always involve a double forecast; first, of the course of events without the proposed reform, and then of their probable course if it be introduced.

The central point of those schemes of reform called Socialism is the abolition, to a greater or less extent, of rights of property. We have hitherto, in this book, tacitly assumed a particular system of law, particularly of law regulating "property" or "ownership." Simple and natural as the notion of ownership may appear (the germ of it is said to be exhibited by a dog with his bone), it is beyond question that the laws regulating it have had a long history of evolution. The first clearly-defined notions of ownership seem to have recognised joint, rather than individual, property; the bulk of the

goods enjoyed by members of the community belonged to the *community*—the family or the State; and the history of property hitherto has constantly tended to making rights of property more distinct, and giving greater firmness to the individual's hold on them. When, therefore, the Socialist proposes a vast curtailment of the individual's property rights, the first reflection that occurs is that he is advocating a return to a form of social organisation which mankind has passed through and outgrown. It is replied that advanced societies are, in fact, rapidly becoming Socialistic; the sphere of Governmental economic activity is being enlarged (railways, gas, water, &c.), and, in the United States especially, large combinations are monopolising trade, and might advantageously be incorporated with the Government. Further, it is urged that private ownership of capital is ethically wrong. "Property is Robbery," it is said, though not, of course, in condemnation of the individual owner of property.

The theory that value is proportional to labour having been adopted, it was inferred that value is produced solely by labour, but that the labourer receives in money-wages less than the full value of the product, the surplus value going to the other participants in distribution, as rent, interest, and profit. Hence, "property," which permits this spoliation of the labourer, is "robbery," and the remedy is state-, instead of private-, ownership, of all instruments of production (land, factories, machines, tools, &c.). This involves organisation of industry by the State's chosen representatives, instead of by the bargaining and competition of private persons or voluntary combinations; and the distribution of the collective output in proportion to the quantity of work done by each person.

It would not be difficult for the State to seize all the property of its subjects. But how could the State secure diligence in labour and wisdom in direction, without the stimulating and controlling effects of the institution of private property? It must be remembered that a very trifling falling-off in either respect would convert gains into losses. If labourers worked with but a little less energy and attention, if captains of industry exhibited but a little less acuteness and promptness, if capitalists showed but a little less wisdom in their choice of investments, if landlords were but a little less eager to get the best rents, the productive powers of the community would decrease, and although landlords, capitalists, and employers

would suffer, yet labourers would not benefit, but would themselves suffer yet more bitterly. It is private property and its consequences that produce the universal diligence and vigilance that high productivity demands. What can take its place? Socialism has often been tried in various forms and on various scales, and has always failed after a short time. Idleness, dissension, incapacity, have always defeated the experiment.

QUESTIONS AND NOTES.

1. Compare the respective advantages and drawbacks of an industrial society organised on (*a*) a competitive, (*b*) a non competitive or socialistic basis, as respects (*a*) the production, (*b*) the distribution of wealth.

(*A.S. of Taxes.*)

In addition to what has been said above, the following points may be noted. As to production: there would probably be much less production, less diligence, less vigilance, less luxury and refinement, in the socialistic state. On the other hand, competition often causes a waste of power, *e.g.*, in advertising, in having many overlapping organisations for work which could be more economically done by one, &c. As to distribution: in the competitive state, wealth is distributed in accordance with the actual social estimate of the value of services rendered to society. In the socialistic state, distribution would take place in accordance with some ethical standard; either according to work done, or effort put forth, or needs. There would probably be very little wealth available for distribution, whichever basis were adopted.

CHAPTER XXIX.

ORGANISATION OF LABOUR.

1.—Out of the circumstances that highly-organised industry brings large numbers of wage-labourers under common guidance, and that labourers are men, and not machines, arises a need for some kind of organisation among the labourers themselves, for their own purposes, distinct from that organisation which we have traced under the head of Production.

I.—STRIKES.

2.—Labourers bargaining individually with their employer are often at a disadvantage (xxiii., 5). "Collective bargaining" is therefore resorted to. It would usually be ineffectual for a single workman to say to his employer, "I will not continue to work for you unless you give me higher wages."

But the whole body of labourers, acting in concert, may be successful in gaining their end by such a threat. The single labourer is not indispensable to the employer; the whole of his labourers are so. If the employer refuse the concession, and the labourers carry out their threat, their cessation of work is called a Strike. A corresponding refusal, on the part of an employer, to give employment in consequence of his workpeople's rejection of some demand on his part, is called a *Lock-out*.

Strikes have been called "the insurrections of labour." As the phrase suggests, they are a terrible remedy, only justifiable in extreme cases. They frequently fail to effect their immediate object, they sometimes drive a trade away from a district or a country, the enforced idleness often engenders bad habits, and causes the weakening of good ones. The best result a strike can have is to render employers unwilling subsequently to refuse a just demand or terms which are as favourable to the labourers as they can reasonably be made.

II.—TRADE UNIONS.

3.—The amount of organisation which is required for a strike is but small, and may be improvised for the occasion. When this is the case, the action of the men may be hasty and ill-advised. More permanent forms of organisation are therefore sought. A Trade Union is a voluntary, continuous association of wage-earners for the purpose of maintaining or improving the conditions of their employment. Its aims may be divided into two classes:—

(1) To substitute collective bargaining for the bargaining of isolated workmen with employer, and to check competition among labourers.

(2) To provide mutual assistance in case of sickness, &c.

The Union being a permanent organisation, its officers can negotiate with employers, and thus, in many cases, avert strikes. It often happens that members of a trade union in a particular place desire to strike, but are deterred by the advice of the general body of members.

Trade Unions, with their practical aims, directed towards possible and immediate improvement, are characteristically English. In other countries, Idealistic and Socialistic views are indulged.

4.—**How to Raise Wages.**—The raising of real wages,

or the prevention of a fall, is the main object of Strikes and Trade Unions. Strikes, therefore, are likely to take place at periods of either rising or falling prices; in the former case with the object of sharing in the rise, in the latter of resisting the reduction of wages which may be necessary. As to the conditions of success, it may be said broadly that Strikes and Trade Union negotiations cannot keep real wages permanently higher than effective bargaining and competition would do without them. When trade is improving, employers would be willing to raise wages, if pressed; they are not likely, however, to offer the rise without being pressed, and pressure may be effectively applied by the Union. On the other hand, when prices have to be reduced, if the Union persists in resisting a reduction of wages, some employers, being no longer able to make a profit, may give up or reduce their business, the demand for labour may decrease, and either wages will fall, or some of the men will be unable to get employment in that trade.

A Trade Union is in effect a combination of producers of a particular commodity, *viz.*, Services of a certain kind. It is, therefore, a monopolist, and its power over price resembles that of monopolists in general; *i.e.*, it may fix wages high, but to maintain such a level may have to limit the output. But it is not in every case that such limitation can be successfully effected. The following circumstances have to be taken into account:—

(1) Can the product of the trade in question be obtained in some other way? As for example—

(*a*) From non-Union labourers.

(*b*) Or from some other district, where the conditions of labour are beyond the control of the Union. Importation of goods thus checks monopoly prices among the home-producers of similar goods.

(*c*) Or by means of machinery, &c. In many cases, mechanical inventions to dispense with hand-labour have been made in order to evade demands for higher wages.

(2) Will the price of the product of the trade be much raised by a stinting of supply?

(3) Is the proportion of the wages in question to the total expense of production of the finished article small or large? If large, then the rise in wages will greatly raise the expense of production, and probably greatly diminish demand. But if small, the demand may not be greatly affected.

(4) If the price of the finished article is raised by limitation of output, will other classes of producers who contribute to the output be able to secure a greater share of the increase?

The difficulty of securing all the necessary conditions, makes the cases rare in which a class of labourers can benefit themselves by maintaining a monopoly. As we have seen (ch. xxiii), the true mode of raising real wages is by increasing the efficiency of industry. The Union can aid the labourer to secure his fair share of the increased product, by diminishing his disadvantages in bargaining. But where the Union so acts as to diminish efficiency, it can, at the best, only benefit one class of labourers at the expense of others.

"The power of Unions to raise general wages by direct means is never great; it is never sufficient to contend successfully with the general economic forces of the age, when their drift is against a rise of wages. But yet it is sufficient materially to benefit the worker, when it is so directed as to co-operate with and to strengthen those general agencies, which are tending to improve his position morally and economically. And it will be so directed if the following conditions are satisfied. Firstly, Unions must aim at making business easy and certain; this is already done by formal and informal Boards of Conciliation in some trades, especially such as produce largely for foreign markets. Secondly, they must aim at raising the Standard of Life among the workers of the present and the coming generation, by fostering habits of sobriety and honesty, independence and self-respect; this is done in different degrees by all Unions; and whatever influence they exert in this direction is cumulative. Thirdly, they must aid as many as possible of the rising generation to acquire industrial skill, and to join the higher paid ranks of labour. This calls for some self-sacrifice, and is inconsistent with any attempt to raise very high the wages in skilled trades by making the entrance to them artificially difficult. Fourthly, they must strive to develop the great stores of business power and inventive resource that lie latent among the working classes, so that, production being economical and efficient, the National Dividend [*i.e.*, total produce of industry] may be large; and that, business power being cheap, and the share going as Earnings of Management being relatively

small, that which remains for wages may be high. . . . Fifthly, they must be always specially careful to avoid action by which one class of workers inflict a direct injury on others. Contests between Unions contending for the same field of employment —as for instance, between Unions of shipwrights and carpenters, or plumbers and fitters—attract their full meed of attention; but more importance really attaches to the injuries which one trade inflicts on others by stinting the output of the raw material which they have to use, or by throwing them out of work through a strike in which they have no concern." (A. MARSHALL, *Economics of Industry*).

III.—CONCILIATION AND ARBITRATION.

5.—Agreement between masters and men, "Industrial Peace," as it has been called, in antithesis to "Insurrections of Labour," may be promoted by Conciliation and Arbitration.

A Board of Conciliation is a body composed of representatives both of masters and men, who meet together to discuss matters in dispute, or which may possibly come into dispute, and to endeavour to arrange them amicably. Arbitration is the submission of a dispute, by agreement of the parties thereto, to the decision of a third party. Conciliation is greatly to be preferred to arbitration—

(1) There is a possibility that the decision of an arbitrator may not be accepted by one or either of the parties.

(2) There is a contentious feeling aroused by each side endeavouring to obtain an award in its favour. But although Conciliation may adjust or prevent most disputes that arise or threaten to arise, there is generally a residue of questions as to which agreement cannot thus be secured, and for these arbitration is the best solution. Conciliation and Arbitration are facilitated by the existence of Trade Unions, which are able to bring the views of the workmen before the board fully and with authority, and also to guarantee that the workmen will observe the terms of any award given in pursuance of a submission to arbitration.

In France and Belgium, "*Conseils de prud 'hommes*" are formed for purposes similar to those of Conciliation Boards, and appear to be very successful. Their decisions are legally enforceable. It does not seem to be desired to give such effect to the recommendations of English Boards of Conciliation.

IV.—SLIDING SCALES.

6.—Another device for maintaining Industrial Peace is the adoption of a Sliding Scale, that is, an agreed rate of wages, varying with variations in the selling price of the product. The Sliding Scale effects an "automatic regulation of wages," and resembles profit-sharing. It gives steadiness to trade, and also to wages, and has been tried with success in the coal and iron industries.

7.—**History of Trade Unions.**—Associations among the members of a trade have existed in every period of industrial history. In the Middle Ages there were "craft-gilds," to which both masters and workmen were admitted. Their objects seem at first to have been moral welfare, and the maintenance of a high standard of work. Later, they practised oppression, by limiting the number of members, and preventing non-members from exercising the trade. But such associations belonged to the "small system" of production, and differ from Trade Unions in the fundamental circumstance that membership of the latter is confined to wage-earners.

During the 18th century that change from the "small" to the "large" system of production, which is called the Industrial Revolution, took place. Previously it was the rule that every master and every journeyman in a trade had been apprenticed. The apprentice in due time became a journeyman, the journeyman had good prospects of becoming a master. These prospects became less as the "large" system extended. Masters and men now began to form separate social classes, with different and often hostile interests; large capital became necessary to set up in business; labourers as a body could no longer look forward to themselves becoming employers. A new kind of labour-organisation was wanted, and the modern Trade Unions came into existence.

During the period when craft-gilds were the appropriate voluntary organisation of masters and men, statutes were made from time to time for the regulation of industry; hours of labour, and rates of wages, were thus fixed, instead of by free agreement. One of the most celebrated of these acts, the Statute of Apprentices, in the reign of Elizabeth, embodied the typical ordinances of the mediæval gild. Justices

were to fix rates of wages every year; the number of apprentices that an employer might have, and the conditions of apprenticeship, were prescribed.

During the period of transition from the small to the large production, frequent attempts were made to enforce the regulative laws, but unsuccessfully, since those laws were becoming obsolete by reason of the change in economic and social conditions, and such attempts were abandoned in the latter part of the 18th century, although the Statute of Apprentices was not formally repealed until 1825. It may be noted incidentally that during this period some associations were formed, which are sometimes called trade unions, with the object of enforcing the old system. The transition period was a time of anarchy. The mediæval legal regulation was not enforced, but the mediæval servile restrictions on the labourers' freedom to combine for their own purposes were not relaxed. In 1799 an act was passed, consolidating many previous enactments, which prohibited all combinations for obtaining an advance in wages or lessening the hours of work. The Combination Laws were repealed in 1824. By this repeal, which gave men the power legally to make collective bargains, and to withhold labour from the market by concerted action, a great impetus was given to Trade Unionism, which had been in existence for 100 years in spite of the Laws.

From 1825 to 1840, Trade Unionism became merged in the Socialistic and Revolutionary movements of the times—Owenism and Chartism. From 1840 to 1860, "laying aside all projects of Social Revolution, Trade Unionists set themselves resolutely to resist the worst of the legal and industrial oppressions from which they suffered, and slowly built up for this purpose organisations which have become integral parts of the structure of a modern industrial state." The period was marked by the spread of education, the prevalence of practical counsels, and increased national economic prosperity.

In 1875 a further change was made in the law, the effect of which was to put employer and workmen on an equality; workmen were no longer to be liable to imprisonment for breach of contract; peaceful "picketing" was expressly permitted; violence and intimidation were to be dealt with by the general principles of criminal law; no act committed by a group of workmen was to be criminal unless the same act by an individual was itself a criminal offence. Collective

bargaining, with all its necessary accompaniments, was, after 50 years of legislative struggle, formally recognised by the law of the land.

It has been estimated that in 1892 there were 7 millions of manual workers over 21 years of age in the United Kingdom, and that of these 1½ millions were members of Trade Unions.

The first Trade Union among agricultural labourers was formed in 1872.

Since 1889 a "New Unionism" has made itself heard. Unions had hitherto been confined to skilled workmen, but in that year a great strike of dock labourers took place in London, and gave rise to organisations among unskilled workers, and to agitations appealing to popular sympathy, and with Socialistic aims.

V.—Government Regulation.

8.—Many economists have opposed any form of government interference between employer and labourer, on the ground that the parties know their own interests best, and that such interference will ultimately injure rather than benefit those for whose good it is intended. We have seen, however (xxiii., 5), that the labourer has not that full power of bargaining which is assumed in the arguments for *laisser faire*. More especially is this the case in regard to women and children. "The beginning of the present century found children of five, and even of three years of age, in England, working in factories and brick-yards; women working underground in mines, harnessed with mules to carts, drawing heavy loads; found the hours of labour whatever the avarice of individual mill-owners might exact, were it 13, or 14 or 15; found no guards about machinery to protect life and limb; found the air of the factory fouler than language could describe, even could human ears bear to hear the story" (F. Walker, *Political Economy*).

Many employers were unwilling to continue such a state of things, but were unable, without legislative support, to alter their methods of production, for fear of being undersold by less scrupulous competitors. Legislation accordingly was undertaken in 1802, and has been steadily extended since then, for the protection of the weaker classes of labourers. A minimum age is fixed for employment; up to a further limit the hours of work are restricted; holidays are prescribed;

certificates of health are required; and a strict inspection of factories is made.

Technical and Commercial Education are now being supplied in England at the public expense. Under the "small" system of production, apprenticeship was universal. Now it is exceptional. Hence, there is a danger that the bulk of the people will grow up without the training necessary for developing their industrial capabilities, and, therefore, unable to earn a decent living.

Proposals have been made that government should limit, in some occupations at least, the hours of labour of adults. It may be admitted—

(1) That character suffers if hours of labour are too long to permit a man to attend to his other duties—his family, his citizenship, his own recreation and cultivation.

(2) That quantity and quality of output are at their highest, in arduous occupations, when moderate hours are worked.

There might be a greater output, for instance, in nine hours than in ten. "On the Great Northern Railway there was a celebrated gang of navvies, who did more work in a day than any other gang on the line, and always left off work an hour or an hour and a-half earlier than any other men." It is only fair to add, "Every navvy in this powerful gang was a teetotaller" (Brassey, *Work and Wages*).

As to quantity and quality of work done, differences in energy and skill are of infinitely more account than differences in hours of work per day; and if, in any trade or trades, a reduction of hours would increase energy or skill, and such reduction cannot be accomplished without legislation, it might be worth while to incur the evils of adding to our already overgrown statute-book. Whether such increase would probably result from such reduction is a question of detail and statistics, which cannot be settled by general reasoning.

It seems to be thought sometimes that hours might well be shortened in trades whose products do not compete with imported goods, but that those who work for a foreign market, or are pressed by foreign competition, must be shut out from such advantage. But if hours were shortened in all trades, and in all an equal diminution in production took place, *relative advantage* would not be altered, and foreign trade, therefore, would not be affected; except that, our produce being diminished, both imports and exports would be likely to fall off.

9.—**Immigration.**—The effect of immigration on wages resembles that of an increase of the wage-earning class from within. Those, therefore, who urge the labourers to restrict their numbers, or to restrict the numbers of those in a trade, should also object to allowing foreign labourers to come into this country. Those who hold the Efficiency Theory, should object to the immigration of labourers with a low Standard of Life.

In order to obtain the greatest economic results, perfect freedom of industrial as well as of commercial competition is necessary. But the question of movements of population is too large to be dealt with by economic science alone.

QUESTIONS AND NOTES.

1. What are Trades Unions? Describe their economic effect. (*L.C.C., Jun.*)

2. Give a brief account of the origin and history of Trade Unions, pointing out what you consider to have been their main aims, and the extent to which they have been successful. (*Cert.*)

3. What councils have been proposed for averting strikes? Under what condition of the market are strikes generally resorted to? Tell briefly what you know of the various methods that have been tried or proposed to avert strikes. How far have they been, or are they likely to be, successful. (*Cert.*)

4. How far do you think it possible for Trades Unions to raise wages? Discuss their means of doing this. (*Cert.*)

5. What would be the economic consequences of the compulsory enactment of a fixed working day, the same for all industries and districts within the country? What effects, if any, would such a measure have upon regularity of employment? (*A.S. of Taxes.*)

One argument against short hours of work in trades which use much Auxiliary Capital is that such Capital becomes expensive, since it stands so many hours idle. This objection might be met by having two "shifts"; thus, each man might work only eight hours, but the machinery might run for 16 hours per day.

6. What are the arguments for and against the "eight hours' day"? What effects on the wealth and progress of the country would its adoption have (*a*) in all industries, (*b*) in those mainly producing articles for export? (*Cert.*)

7. What would be the probable effects of a statutory "8-hours'-day" on Wages, Profits, Foreign Trade? Are there any reasons why such a legislative restriction should be applicable to certain trades and not to others?

8. What are the principal economic causes of the degradation of labour? What attempts have been made to deal with them (*a*) by trades unions, (*b*) by the State? (*A.S. of Taxes.*)

CHAPTER XXX.

STATE AID TO THE POOR.

1.—**The Poor Laws.**—A pauper class first made its appearance in England in the time of Henry VIII. Prices of commodities were rising, in consequence of the influx of the precious metals from America, yet wages were kept down by law and custom. In addition, the religious houses, which had to some extent cared for the poor, were broken up and their property confiscated. An attempt was made to deal with the disorganisation and suffering caused by these changes. Alms-giving was prohibited by statute, and collections were ordered to be made in each parish for the impotent poor. Charity, however, seems to have responded but feebly to the law's command, for, under Edward VI., bishops were authorised to proceed against persons who should refuse to contribute to such collections, and, under Elizabeth, the form of charity had to be abandoned. Contributions were made compulsory, and justices were empowered to decide what constituted a reasonable contribution. The modern English poor-law system dates from an Act of 1601, which gave every person a legal right to relief, and imposed liability to taxation for that purpose on the body of inhabitants; but it discouraged voluntary pauperism, and directed that the able-bodied should be made to work. Up to the accession of George III. (1760) the general principle governing the administration of the poor-law was the reasonable one that the condition of the pauper should be less agreeable than that of the self-supporting labourer. In the early part of the 18th century a kind of workhouse test had been adopted. That is, residence in the workhouse might be made a condition of receiving poor-relief.

But in the latter part of the century a different policy was pursued. A paternal solicitude for the poor was displayed; the workhouse test was abandoned, and out-door relief given even to the able-bodied. In 1782 Gilbert's Act gave power to form Unions of parishes, and to build a workhouse for the Union; only the "impotent" poor were to be sent to the workhouse, and the guardians of the poor were ordered to find suitable employment for the able-bodied near their own homes.

Modern advocates of the Right to Labour and the Duty of Government to find work for all, are, therefore, far from being innovators; in 1782 the English Legislature was of their way of thinking.

In 1795 occurred what has been called the "Speenhamland Act of Parliament"; not a statute, but merely an order of certain justices of the peace at Speenhamland, in Berkshire, that allowances should be made out of the rates to poor labourers in aid of their wages. In the following year the "decisively fatal step" was taken of legalising such relief. The results were most disastrous. By 1832 pauperism had become almost universal among the lower classes of labourers. In some parishes, lands were deserted because of the pressure of the poor-rate, which rose to 10/- per head of the population. Wages fell, their deficiency being made up from the rates. Labourers were ruined, either morally, by the loss of their independence, and reliance on public assistance, or economically, if they kept off the rates, by their inability to maintain themselves in a state of efficiency. It was found that, on the average, while the pauper received 151 ozs. of solid food per week, the self-supporting labourer received only 122. The moral disorder which accompanied this state of things could hardly be exaggerated. It justifies the remark that though the legislator's power for good may be restricted, he has no reason to complain of any limitation on his power for evil.

The extent and cause of the mischief having been ascertained by full investigation, the Poor Law Amendment Act of 1834 restored the earlier system. The workhouse test was revived; allowances in aid of wages were abolished; and the law of "settlement" was relaxed. The consequent improvement in the condition of the people was immediate and rapid.

The law of *Settlement*, which originated or was systematised in the reign of Charles II., was of a remarkably barbarous character. A person obtained a "settlement" in a parish, *i.e.*, a right to poor relief there, by birth, or residence, or owning property therein. Any person who came into a parish where he was not settled, and was considered to be likely to become chargeable to the parish, was liable to be forcibly returned to his place of settlement. In 1795 it was enacted that persons should only be removeable on becoming actually chargeable.

Other examples of servile restriction are the laws of the Middle Ages, which forbade agricultural labourers and servants

to leave their town or district, and which, down to 1824, prohibited artisans from leaving the kingdom.

2.—**Old-Age Pensions.**—It has been proposed that maintenance in old age should either wholly or in part cease to be a personal responsibility, and become a public charge. But no satisfactory scheme has been put forward.

(1) Canon Blackley has proposed to compel every person to purchase a pension for periods of sickness and for old age. The sickness pension was abandoned because of the risk of fraud by pretended sickness, &c. And the old-age proposal has also been abandoned in favour of a proposal to "give a weekly half-crown from public funds to every workman who saves half-a-crown for himself." Such a scheme, however, would not benefit the poorest, who could not save at all, and would involve the greatest difficulty in selecting the persons who should be permitted to avail themselves of it.

(2) Mr. Charles Booth has proposed a gratuity of 5/- per week to all (both rich and poor) over the age of 65.

(3) A Royal Commission has studied the question, but has not been able to discover or devise any scheme which they could recommend.

In spite of the sentimental attractions of the idea, the objections to it seem insuperable. Why select old age for special relief? Widowhood, orphanage, lingering disease, &c., are not so easily foreseen or provided against. The fear of destitution, or in the alternative, poor relief on the strict system re-established by the Poor Law Amendment Act of 1834, stimulated the friendly society system, a system of self-help. The absence of a habit of saving is a great cause of the unstable, unhappy condition of many members of the labouring classes. To make old age a public charge would be to destroy one of the most powerful motives which is tending to rescue the poorer classes from a mere hand-to-mouth existence.

During the past 30 years pauperism in this country, including old-age pauperism, has largely decreased, and providence and prosperity among the labouring classes have largely increased. We may hope that this process of improvement will continue, and we may fear that any scheme of old age pensions would tend to weaken the independence and self-reliance of the labouring classes, and to do more harm than good.

In Germany there exists a very complete system of compulsory insurance for old age. In that country there is a degree of Government regulation in most branches of human activity, which Englishmen consider intolerable. There is also a strong tendency to Socialism and Revolution; and the elaboration of compulsory insurance is largely due to the necessity of doing something to check popular dissatisfaction. The principle adopted is that of compulsory contributions, exacted from workmen and masters, and assisted by fixed State grants. The benefits are very small, and the time of life at which those for old age begin is very late, namely 70. The allowance is not enough to live on.

In Denmark there is a pension scheme in operation, no previous contributions being required.

QUESTIONS AND NOTES.

1. Explain how the rate of wages is affected by poor relief from public funds. What are the evils attending out-door relief? (*Cert*).
2. Discuss from both an economical and a social standpoint, the question of a general old-age pension. (*Cert.*)
3. It has been proposed to give every person over the age of 65 a pension of 5/- a week out of the taxes. Discuss any objections you see to doing this. (*Cert.*)
4. Give an account of the chief stages in the history of the English Poor Law. What economic lessons may be drawn from that history? (*A.S. of Taxes.*)

MISCELLANEOUS QUESTIONS.

1. Discuss the question "how may a teacher's study of Political Economy help him to teach Geography and History?" (*Cert.*)

2. Point out briefly the economical distinction between Wealth and Capital; Profit and Interest; Value and Price; Value and Utility. Give simple illustrations. (*Cert.*)

3. Explain and illustrate the following statements:—
   (*a*) Labour is not creative of objects, but of utilities.
   (*b*) Industry is limited by capital.
   (*c*) The cost of labour varies with the Standard of Comfort.
   (*d*) The rate of interest tends to decline. (*Cert.*)

4. Prepare the outlines of a lesson to an advanced class on one of the following passages:—
   (*a*) "Consols were on Friday, October 7th, 102 to 102¼. Bank rate 4 p.c."
   (*b*) "Industry is limited by Capital."
   Or, (*c*) "Banking transfers capital from the inactive accumulator to the active and energetic person who wants capital." (*Cert.*)

5. Give notes of a lesson on what is implied by the phrase, "A free breakfast table," or on Allotments. (*Cert.*)

6. Prepare the outlines of a lesson to an advanced class on—
   (*a*) The history of the poor laws, especially in their bearing upon the rate of wages;
   Or, (*b*) The evils of monopolies;
   Or, (*c*) The various modes of tenancy of agricultural land. (*Cert.*)

7. Prepare the outline of a lesson to an advanced class on one of the following:—
   (*a*) The relations of capital and labour;
   (*b*) The considerations which govern the rate of wages;
   (*c*) Councils of conciliation and arbitration between the employer and the workman. (*Cert.*)

8. Give from your reading or observation a few examples of the guidance afforded to commercial and social legislation by well-established economic principles. (*Cert.*)

9. Write notes of a lesson on colonisation. (*Cert.*)

10. Explain the meaning of the following terms:—unfavourable exchange, reciprocity, capital, paper currency, bimetallism. (*L.C.C., Jun.*)

11. "There is a vast field of economic relations within which occur gains which no man loses, and losses which no man gains."
Briefly refer to questions of Trade, of Wages, of Taxation, and of Monetary Policy respectively, in which this truth is illustrated. (*B.I., Prel.*)

12. Define the terms:—Marginal Utility, Efficiency Wages, Elasticity of Demand, Legal Tender, Banking Reserve, Fiduciary Issue. (*B.I., Prel.*)

13. Explain the following terms:—Diminishing Return, Standard of Comfort, Legal Tender, Mint Price of Gold, Banking Reserve, Close Price. (*B.I., Prel.*)

14. Define the following, and give examples of cases where their value becomes negative:—Marginal Utility, Price, Rent of Ability, Interest, Cost of Production, Wages, Diminishing Return. (*B.I., Fin.*)

15. Give a careful analysis of the conditions and forces which enable one country to become wealthier than another. Illustrate by reference to actual cases. (*B.I., Prel.*)

16. Discuss fully the economic arguments for and against free education. Should any distinction be made between (*a*) primary, secondary, and University education; (*b*) general and technical education, in this connection? (*A.S. of Taxes.*)

17. Distinguish carefully between the following:—(*a*) The law of increasing and the law of diminishing returns, (*b*) depreciation and debasement of money, (*c*) normal and market value, (*d*) exchanges at a premium and exchanges at a discount, (*e*) proportional and progressive taxation. (*A.S. of Taxes.*)

18. Distinguish carefully between the following terms:—(*a*) Cost and expenses of production; (*b*) total and final utility; (*c*) depreciation and debasement of money; (*d*) positive and preventive checks on population; (*e*) free and gratuitous coinage; (*f*) exchanges at a discount and exchanges at a premium. (*A.S. of Taxes.*)

19. Explain the following terms:—Standard of Comfort, Efficiency Wages, Profit Sharing, Token Coinage, Legal Tender, Gresham's Law, Gold Point of Exchange, *Ad Valorem* Duty, Progressive Taxation. (*A.S. of Taxes.*)

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I.—PICKETING.—Stationing workmen who are on strike where they may meet others on their way to and from work, to endeavour to persuade them to join the strike.

II.—RATTENING.—The use of violence or intimidation, to induce workmen to join a strike.

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1.—STATISTICS.—The science, or the portion of several sciences, which consists in collecting and arranging such facts and figures as belong to the moral sciences, *i.e.*, the sciences whose subject matter is human conduct.

II.—STOCK EXCHANGE (p. 113, 114, 115).—Dealers are either stock brokers who act as agents for the public, or stock jobbers, who buy and sell on their own account. The jobbers are remunerated by "the turn of the market," the brokers by a commission, a direct charge to their principal.

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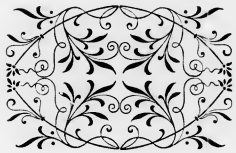
TERRITORIAL DIVISION OF LABOUR.—A phrase intended to sum up the nature of International Trade.



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